

# EXHIBIT D

**COMMONWEALTH OF PUERTO RICO**

**Comprehensive Annual Financial Report**

**Fiscal Year Ended June 30, 2006**

# **COMPREHENSIVE ANNUAL FINANCIAL REPORT**

*Fiscal Year Ended June 30, 2006*



***Commonwealth of Puerto Rico***

***Honorable Aníbal Acevedo Vilá***  
***Governor***

*Prepared by:*

***Puerto Rico Department of the Treasury***

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***Assistant Secretary of Central Accounting***

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**COMMONWEALTH OF PUERTO RICO**

**Comprehensive Annual Financial Report**

**Year ended June 30, 2006**

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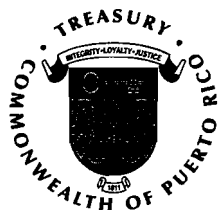
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## **INTRODUCTORY SECTION**



Juan C. Méndez Torres, Esq., CPA  
Secretary

August 6, 2007

To the Honorable Governor of Puerto Rico,  
Members of the Legislature, and People of Puerto Rico:

It is a pleasure to submit, for your information, the Comprehensive Annual Financial Report (CAFR) of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the fiscal year ended June 30, 2006. This report, presented in three sections, Introductory, Financial, and Statistical, is the primary means of reporting the Commonwealth's financial activities.

The introductory section, which is not audited, includes this letter of transmittal, general information about the Commonwealth, a list of the Commonwealth's principal elected and appointed officials at the balance sheet date, an organizational chart, and a reproduction of the Certificate of Achievement for Excellence in Financial Reporting that the Commonwealth received for its June 30, 2005 CAFR. The financial section contains the independent auditors' report, management's discussion and analysis (MD&A), and the basic financial statements as listed in the table of contents. The financial section also includes the notes to the basic financial statements, required supplementary information, and other supplementary information. The statistical section, which is not audited, includes selected financial and demographic information, generally presented on a multiyear basis.

### **PROFILE OF THE COMMONWEALTH**

The Puerto Rico Department of the Treasury is responsible for the preparation of this report. The responsibility for the accuracy of presented data and the completeness and fairness of the presentation, including all of the disclosures, rests on the Commonwealth's management. To the best of our knowledge and belief, the following data, as presented, is accurate in all material respects, and is presented in a manner designed to set forth the financial position and the results of operations of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth as of June 30, 2006 and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with accounting principles generally accepted in the United States of America. We have included all the necessary disclosures to enable the reader to gain a thorough understanding of the Commonwealth's activities.

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The financial reporting entity includes all funds of the Commonwealth, which comprises the primary government, as well as all its component units. In accordance with Governmental Accounting Standards Board's Statement No. 14, the Commonwealth's financial reporting entity includes 48 component units: 6 are blended component units including 3 fiduciary component units, 7 major discretely presented component units, and 35 nonmajor discretely presented component units. Component units are legally separate entities for which the primary government is financially accountable, or other organizations; the nature and significance of whose relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading and incomplete. Blended component units, although legally separate entities, are, in substance, part of the primary government's operations and are included as part of the primary government. Discretely presented component units, both major and nonmajor, are reported in a separate column in the government-wide financial statements to emphasize that they are not part of the primary government and to differentiate their financial position and results of operations from those of the primary government.

Generally, each component unit issues audited financial statements, which can be obtained from the component unit's administrative offices. The basic financial statements included in the financial section of this CAFR provide descriptions of the operations of each of the following component units of the Commonwealth:

*Blended Component Units:*

Public Buildings Authority  
Puerto Rico Maritime Shipping Authority  
The Children's Trust

*Discretely Presented Component Units:*

Agricultural Services and Development Administration  
Automobile Accident Compensation Administration  
Cardiovascular Center Corporation of Puerto Rico and the Caribbean  
Caribbean Basin Projects Financing Authority  
Economic Development Bank for Puerto Rico  
Employment and Training Enterprises Corporation  
Farm Insurance Corporation of Puerto Rico  
Fine Arts Center Corporation  
Governing Board of the 9-1-1 Service  
Government Development Bank for Puerto Rico  
Institutional Trust of the National Guard of Puerto Rico  
Musical Arts Corporation  
National Parks Company of Puerto Rico  
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives



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Puerto Rico Aqueduct and Sewer Authority  
Puerto Rico Conservatory of Music Corporation  
Puerto Rico Convention Center District Authority  
Puerto Rico Council on Higher Education  
Puerto Rico Electric Power Authority  
Puerto Rico Government Investment Trust Fund  
Puerto Rico Health Insurance Administration  
Puerto Rico Highway and Transportation Authority  
Puerto Rico Industrial Development Company  
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities  
Financing Authority  
Puerto Rico Infrastructure Financing Authority  
Puerto Rico Land Administration  
Puerto Rico Land Authority  
Puerto Rico Maritime Transportation Authority  
Puerto Rico Medical Services Administration  
Puerto Rico Metropolitan Bus Authority  
Puerto Rico Municipal Finance Agency  
Puerto Rico Ports Authority  
Puerto Rico Public Broadcasting Corporation  
Puerto Rico Solid Waste Authority  
Puerto Rico Telephone Authority  
Puerto Rico Trade and Export Company  
Right to Employment Administration  
Special Communities Perpetual Trust  
State Insurance Fund Corporation  
Tourism Company of Puerto Rico  
University of Puerto Rico

*Fiduciary Component Units:*

Employees Retirement System of the Government of Puerto Rico and its Instrumentalities  
Puerto Rico Judiciary Retirement System  
Puerto Rico System of Annuities and Pensions for Teachers



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### **Independent Auditors**

Commonwealth statutes require an annual audit by independent certified public accountants. The firm of KPMG LLP was selected by the Commonwealth to perform the audit of the basic financial statements in accordance with auditing standards generally accepted in the United States of America for the fiscal year 2005-2006. The goal of the independent audit was to provide reasonable assurance that the financial statements of the Commonwealth for the fiscal year ended June 30, 2006 are free of material misstatements. The independent auditors' report on the basic financial statements is included in the financial section of this report.

### **Internal Controls**

The management of the Commonwealth is responsible for establishing and maintaining internal controls to ensure that assets of the Commonwealth are protected from loss, theft, or misuse, and that adequate accounting data is compiled for the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America. The internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

As a recipient of federal assistance, the Commonwealth is also responsible for ensuring that internal controls are in place to ensure that documents and processes are in compliance with applicable laws and regulations related to such federal financial assistance programs.

Certain departments, agencies, and political subdivisions are subject to the requirements of the U.S. Office of Management and Budget Circular A-133. As a result, these entities are audited for compliance with the requirements of the federal financial assistance programs. These audits are performed at the department or agency level. The Commonwealth has provided for the possible cost disallowance that may arise from these audits, as well as from other audits that may be performed by federal grantors.

### **Budget and Fiscal Policy**

The fiscal year of the Commonwealth begins each July 1. The Governor is constitutionally required to submit to the Legislature an annual balanced budget of capital improvements and operating expenses of the Central Government for the ensuing fiscal year.

The annual budget is prepared by the Puerto Rico Office of Management and Budget, working with the Puerto Rico Planning Board, the Puerto Rico Department of the Treasury, and other government offices and agencies. Section 7 of Article 6 of the Constitution provides that *"The appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year unless the imposition of taxes sufficient to cover said appropriations is provided by law."*



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The Commonwealth maintains extensive budgetary controls. The objective of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the Legislature. Activities of the general fund are included in the annual appropriated budget. Budgetary control resides at the department level. The Commonwealth also maintains an encumbrance accounting system as one method of maintaining budgetary control.

The annual budget, which is developed using elements of performance-based program budgeting and zero-based budgeting, includes an estimate of revenue and other resources for the ensuing fiscal year under laws existing at the time the budget is submitted and legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient and in conformity with the four-year investment plan prepared by the Puerto Rico Planning Board.

The Legislature may amend the budget submitted by the Governor, but may not increase items that would cause a deficit without imposing additional taxes to cover such deficit. Once approved by the Legislature, the budget is referred to the Governor, who may decrease or eliminate any item, but may not increase or insert new items in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by a two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, as originally approved by the Legislature and the Governor, it is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This allows the Commonwealth to continue to pay operating and other expenses until a new budget is approved.

### **Governmental Activities**

General governmental activities of the Commonwealth are accounted for in four governmental funds. These funds are: general, special revenue, debt service, and capital project. The general fund is the primary operating fund of the Commonwealth. The general fund is used to account for resources traditionally associated with government, which are not required legally or by sound financial management to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, education, and economic development. Other major funds are the debt service fund, which accounts for the accumulation of resources predominantly for, and the payment of the Commonwealth general long-term bonds' principal, interest and related costs; the Public Buildings Authority capital project fund, which accounts for the financial resources used for the acquisition and construction of major capital facilities; and The Children's Trust special revenue fund, which accounts for the moneys received by the Commonwealth from a global settlement agreement dated November 23, 1998, between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The financial resources received by this fund are used to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico. Nonmajor governmental



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funds are combined in a single column in the governmental fund financial statements, and individually identified in the supplementary combining nonmajor governmental funds financial statements of this report.

### **Business-Type Activities**

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the government is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where the government has decided that periodic determination of net income is appropriate for accountability purposes.

The Commonwealth's proprietary operations comprise the following activities: the Unemployment Insurance Trust Fund, the Lottery of Puerto Rico and the Additional Lottery System (the Lotteries Fund), both major funds. The Puerto Rico Water Pollution Control Revolving Fund, the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, the Disability Insurance Fund, and the Drivers' Insurance Fund are all nonmajor proprietary funds combined in a single column in the proprietary fund financial statements, and individually identified in the supplementary combining nonmajor proprietary funds financial statements of this report.

### **Fiduciary Operations**

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity or as an agent for individuals, private organizations, and other governmental units. These include the pension trust and agency funds. Pension trust funds are established through trust agreements specifying how the fund will operate. Agency funds are custodial in nature and do not report fund balances. The pension trust funds include the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities, the Puerto Rico Judiciary Retirement System, and the Puerto Rico System of Annuities and Pensions for Teachers.

Agency funds consist of the Special Deposits Fund. This agency fund includes deposits under the custody of the Courts of Justice for alimony payments, deposits under the custody of the Commissioner of Insurance of the Commonwealth for escheated property, and for insurance companies under bankruptcy.

### **Cash Management Policies and Practices**

The Commonwealth maintains a cash pool for its cash and cash equivalents. The balance in the pooled cash accounts is available to meet current operating requirements and any excess is invested in various interest-bearing accounts in the Government Development Bank for Puerto Rico (GDB), a discretely presented component unit. In addition, the Puerto Rico Government Investment Trust Fund (PRGITF), was created by the Commonwealth pursuant to Act No. 176 of August 11, 1995, and began operations on December 4, 1995. PRGITF is a no-load diversified collective investment trust that was created for the purpose of providing eligible investors with a convenient and economical way to invest in a professionally managed money market



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portfolio. The deposits on hand and the investments purchased are not collateralized, secured, or guaranteed by the Commonwealth or any of its agencies, instrumentalities, or political subdivisions.

The Commonwealth's investment policy is to minimize credit and market risk while maintaining a competitive yield on its portfolio. The cash temporarily idle during this year was invested mainly in U.S. government securities, stocks, corporate bonds, repurchase agreements, Commonwealth securities, trading securities, and short-term investments. These are primary government investments that are restricted and unrestricted.

### **Capital Assets**

These basic financial statements include the capital assets of the Commonwealth. A discussion of capital assets accounting is included in the MD&A that is part of the basic financial statements. More detailed information about capital assets can be found in the notes to the basic financial statements.

### **Debt Administration**

As of June 30, 2006, the Commonwealth had a number of debt issues outstanding. The Commonwealth has a BBB- credit rating from Standard & Poor's Corporation and a Baa3 from Moody's Investor Service on general obligation bond issues, these classifications may vary in future years.

Section 2 of Article VI of the Constitution of Puerto Rico provides that direct obligations of the Commonwealth evidenced by full faith and credit bonds or notes shall not be issued if the amount of the principal of and interest on such bonds and notes and on all such bonds and notes theretofore issued, which is payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on accounts of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenue raised under the provisions of the Commonwealth Legislation and covered into Treasury of Puerto Rico in the two fiscal year preceding the current fiscal year. Section 2 of Article VI does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. See the computation of the Legal Debt Margin on page 6 in the Statistical Section. More detailed information about long-term debt can be found in the notes to the basic financial statements.

### **Risk Financing**

The Commonwealth purchases commercial insurance to cover casualty, theft, tort claims, and other losses. The current insurance policies have not been canceled or terminated. As it relates to worker's compensation, the Commonwealth's discretely presented component unit, the State Insurance Fund Corporation, provides workers' compensation to both public and private employees.



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### **Financial Advisor and Fiscal Agent**

The principal functions of GDB are to act as financial advisor to and fiscal agent for the Commonwealth, its municipalities, and public corporations, in connection with the issuance of bonds and notes, and to make loans to private enterprises to aid the economic development of Puerto Rico. GDB was the first governmental entity in Puerto Rico to obtain a Certificate of Achievement for Excellence in Financial Reporting for its CAFR. It has received the award for the years ended June 30, 1994 through 2005. GDB is presented as a major discretely presented component unit.

### **ECONOMIC CONDITIONS AND OUTLOOK**

Puerto Rico enjoyed almost two decades of economic expansion through fiscal year 2001. Almost every sector of the economy participated, and record levels of employment were achieved. Factors behind this expansion included government-sponsored economic development programs, periodic declines in the value of the U.S. dollar, which is the currency used in the Commonwealth, increases in the level of federal transfers, a significant expansion in construction investment driven by infrastructure projects and private investment, primarily in housing, and the relatively low cost of borrowing.

The economy of Puerto Rico is closely linked to the United States economy. The following exogenous variables are affected by the United States economy: exports, direct investment, transfer payments, interest rates, inflation, and tourist expenditures.

Puerto Rico has a diversified economy with manufacturing and services comprising its principal sectors. Manufacturing is the largest sector in terms of gross domestic product. Manufacturing in Puerto Rico is now more diversified than during the earlier phases of its industrial development and includes several industries less prone to business cycles. In the last three decades, industrial development has tended to be more capital intensive and more dependent on skilled labor.

The services sector, which includes finance, insurance, real estate, wholesale and retail trade, tourism, and other services has shown a strong interaction with manufacturing, tourism, construction, and agriculture.

Tourism makes a significant contribution to economic activity. An estimated \$3.4 billion were spent by visitors in Puerto Rico during fiscal year 2006. San Juan has become the largest home port for cruise ships in the Caribbean and the fourth largest home port for cruise ships in the world. During the year 2006, the numbers of persons registered in tourist hotels maintain the same occupancy rate of the fiscal year 2005. The construction sector is an integral part of the economic activity from fiscal year 1999 through fiscal year 2006. Puerto Rico is heavily dependent on oil imports for the production of electricity; however, as a result of the construction of two cogeneration plants, one of which is fueled by liquefied natural gas and the other by coal, Puerto Rico's dependence on oil imports for the production of electricity has been reduced from 99% to 72%.

The Puerto Rico Planning Board's preliminary reports of the performance of the Puerto Rico economy during fiscal year 2006 indicate that the economy registered an increase of 0.7% in total real gross product. Gross



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product in fiscal year 2000 was \$41.4 billion and gross product in fiscal year 2006 was \$56.7 billion. This represents an increase in gross product of 36.9% from fiscal year 2000 to fiscal year 2006.

In terms of personal income, in fiscal year 2006, personal income per capita was \$12,997 compared to 12,365 in 2005 and \$10,204 in 2000.

According to the Department of Labor and Human Resources, during fiscal year 2006 the labor force was 1.42 million compared to 1.39 million in fiscal year 2005. Unemployment, although at relative low historical levels, remains above the United States average. The average unemployment rate increased from 10.6% during fiscal year 2005 to 11.7% in fiscal year 2006.

## **Major Initiatives**

### ***Individual Income Taxes***

Resident individuals are subject to tax on their taxable income from all sources. As a result of legislation enacted in 1999 and 2000, there are several changes in income tax brackets applicable to future taxable years. However, due to significant limitation of available resources, the Commonwealth has deferred further reduction in income tax rates through fiscal year 2006, in an effort to maintain revenue levels, and avoid budgetary shortfalls. The Commonwealth worked on a fiscal and tax reform based on sales and uses tax and implemented it during fiscal year 2007.

### ***Proposed New U.S. Tax Regime for Companies Doing Business in Puerto Rico***

In order to enhance the attractiveness for U.S. companies of establishing operations in Puerto Rico, the Commonwealth has been seeking to provide for a new and permanent tax regime applicable to U.S.-based businesses that have operations in the Commonwealth or other U.S. possessions. During the past three years, the Commonwealth has been pursuing an amendment to Section 956 of the U.S. Internal Revenue Code of 1986, as amended (the Code), that would establish a regime based on the tax rules generally applied to U.S. companies with international operations, but with certain modifications intended to promote employment both in the Commonwealth and the United States. The U.S. Congress, however, has not acted upon the proposed amendment to Section 956 of the Code. Also, due to the phase-out of Sections 30A and 936 of the Code, the U.S. Senate designated a special commission through the General Accounting Office to study the economic impact of said phase-out and to present recommendations on alternative tax incentives for U.S.-based companies operating in Puerto Rico. In the meantime, most U.S.-based companies operating under Sections 30A and 936 of the Code have converted from U.S. corporations to Puerto Rico or foreign corporations, which has lessened the impact of the phase-out of those sections.



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### ***Public Sector Debt***

Historically, the Commonwealth has maintained, as a matter of fiscal policy, a prudent relationship between the growth of public sector debt and the growth of the economic base required to service that debt. During certain fiscal years, however, public sector debt increased at a greater rate than the rate of gross product primarily due to an increase in the amount of debt incurred to finance certain key infrastructure projects, which are important to the development of the economy and are expected to produce long-term economic benefits, and debt incurred to refinance outstanding debt to enable Puerto Rico to benefit from the historically low levels of interest rates and realize debt service savings. During fiscal year 2006, public sector debt increased 15%.

### ***Prospects for the Future***

The Commonwealth is committed to research and pursue solutions to improve the Commonwealth's competitive economic performance and the quality of life for its citizens. The Governor of Puerto Rico has established three long-range priorities which he expressed in his March 2005 state of the Commonwealth message. Those priorities, named "El Triangulo del Exito," are: (1) to provide a new economy that generates new employments providing its citizens with the best quality of life, (2) to provide a safe society (3) to establish an excellent educational system for the benefit of the children.

The Commonwealth's economic development program is based on the fundamental, interrelated changes in technology, demographics, and institutions, which are transforming the global economy. These changes provide the challenges and opportunities that encompass the economic development strategy.

The economic program is based on: (1) refocus the economy on biotechnology, telecommunications, technology information, and related sectors, (2) "Apoyo al de aquí" to create new Puerto Rican enterprises, and (3) infrastructure economic planning.

Initiatives to achieve the economic development program objectives have begun in the following five areas: (1) legislation towards economic development through tax and fiscal reform; (2) consolidation and reductions of governmental entities; (3) refocused strategic projects towards excise taxes; (4) reduction of subsidies provided to governmental entities; and (5) refocused strategic projects related to the citizen's health.

The tax reform which is in force since November 15, 2006 replaced the Commonwealth's current excise tax with the sales and use tax, included compensatory income tax credits in order to address any regressive effect the proposed consumption tax may have, eliminate the marriage penalty, establish an earned income tax credit, increase the deduction for charitable contributions, restructure the estate tax system, provide incentives for investments in technological infrastructure and research and development activities, and adopt additional measures to foster individual savings. The Department of the Treasury expects that the tax reform will provide a net increase in the General Fund's annual revenues, after taking into consideration projected



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reductions in income taxes, in an amount sufficient to reduce and eventually eliminate the structural imbalance.

The proposed fiscal reform includes a long-term plan to reduce and improve the management of the Commonwealth's public debt. Upon the elimination of the structural budget imbalance, which elimination must be certified to the Legislative Assembly and the Governor by the Secretary of the Treasury, the Director of OMB, and the President of GDB, the Commonwealth's operating budget will include an annual contribution to the public improvement fund equal to two percent (2%) of the total amount of the public improvement bonds authorized for that fiscal year. The annual contribution to the public improvement fund will increase by an additional two percent (2%) of the then-current authorization for each fiscal year thereafter, up to a maximum of twenty percent (20%) of the current year's authorized public improvement bond issuance. This contribution is intended to reduce proportionally each year the amount of the Commonwealth's public improvement bond issues.

The Commonwealth faces other fiscal challenges besides its current budgetary issues. The principal one involves resolving the increasing unfunded pension liability of the Employees Retirement System of the government of Puerto Rico and its instrumentalities (Employees Retirement System) and the Puerto Rico System of Annuities and Pensions for Teachers (the Teachers Retirement System). The Commonwealth expects to reduce the unfunded liability of the Employees Retirement System based on proposed legislation which provides for increased employer and employee contributions and the issuance of up to \$2 billion of pension obligation bonds, which would be payable from the Commonwealth's general fund. Besides the Employees Retirement System is considering an issue of bonds to improve unfunded pension liability of the fund. The Employees Retirement System and the Teachers Retirement System are also seeking reimbursement from the Commonwealth for certain special retirement benefits paid by them in prior fiscal years under legislation providing such retirement benefits.

### **Financial Condition**

The MD&A, which can be found immediately following the independent auditors' report, provides an overview of the Commonwealth's financial activities addressing both governmental and business-type activities reported in the government-wide financial statements. In addition, the MD&A focuses on the Commonwealth's major funds. Component units and fiduciary activities are excluded from the MD&A.

### ***Preliminary Fiscal Year 2007 Compared to Actual Fiscal Year 2006***

Preliminary general fund total revenue for fiscal year 2007 was \$8,890 million, representing an increase of \$349 million, or 4.1%, from fiscal year 2006 revenue. The 2006 proposed budget package included several new revenue-raising measures sufficient to cover budgeted expenditures, most of which required legislative approval. However, the Legislative Assembly did not approve the budget proposed by the Governor.



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## Other Information

### *Certificate of Achievement*

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a *Certificate of Achievement for Excellence in Financial Reporting* to the Commonwealth for its CAFR for the fiscal years ended from June 1996 through 2002 and 2004 to 2005. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for the preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized CAFR, whose contents conform to program standards. The CAFR must satisfy both accounting principles generally accepted in the United States of America and applicable legal requirements. A Certificate of Achievement is valid for a period of only one year.

We believe the Comprehensive Annual Financial Report of the Commonwealth of Puerto Rico as of and for the fiscal year ended June 30, 2006 continues to conform to GFOA standards and we are submitting it to the GFOA to determine its eligibility for a Certificate of Achievement for Excellence in Financial Reporting.

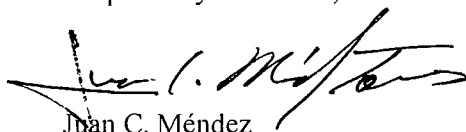
### *Acknowledgements*

The preparation of this report requires the collective efforts of numerous finance personnel throughout the Commonwealth and is made possible only with the cooperation and support of the Executive, Legislative, and Judicial branch agencies, and component units of the Commonwealth. We sincerely appreciate the dedicated efforts of all these individuals.

The report could not have been accomplished without the professionalism and dedication of Juan Torr   Mart  nez, CPA, from our accounting team as well as the rest of the personnel of the Central Government Accounting area. Also, we would like to give special thanks to our independent auditors, KPMG LLP, for their advice and commitment.

This report continues our commitment to the citizens of the Commonwealth of Puerto Rico, the Governor, the Legislature, and the financial community to maintain our general purpose financial statements in conformance with the highest standards of financial accountability.

Respectfully submitted,

  
Juan C. M  ndez  
Secretary of the Treasury



SECRETARY OF THE TREASURY

**COMMONWEALTH OF PUERTO RICO**

**PRINCIPAL OFFICIALS**

As of June 30, 2007

**Aníbal Acevedo Vilá**  
Governor

Members of Cabinet

**Jorge Silva Puras**  
Chief of Staff

**Fernando Bonilla Ortiz**  
Secretary of State

**Roberto Sánchez Ramos**  
Secretary of Justice

**Juan C. Méndez Torres**  
Secretary of the Treasury

**Rafael Aragunde Torres**  
Secretary of Education

**Román Velasco González**  
Secretary of Labor and  
Human Resources

**Rosa Pérez Perdomo**  
Secretary of Health

**José Orlando Fabre Laboy**  
Secretary of Agriculture

**Carlos González Miranda**  
Secretary of Transportation and  
Public Works

**Ricardo Rivera Cardona**  
Secretary of Economic  
Development and Commerce

**Felix Matos Rodríguez**  
Secretary of Family Affairs

**Jorge Rivera Jiménez**  
Secretary of Housing

**Javier Vélez Arocho**  
Secretary of Natural and  
Environmental Resources

**Alejandro García Padilla**  
Secretary of Consumer Affairs

**David E. Bernier Rivera**  
Secretary of Sports and  
Recreation

**Miguel A. Pereira Castillo**  
Secretary of Corrections and  
Rehabilitation

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**LEGISLATIVES OFFICERS**

As of June 30, 2006

**Kenneth McClintock Hernández**  
President, Senate

**José Aponte Hernández**  
Speaker, House of  
Representatives

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**FISCAL OFFICERS**

As of September 1, 2006

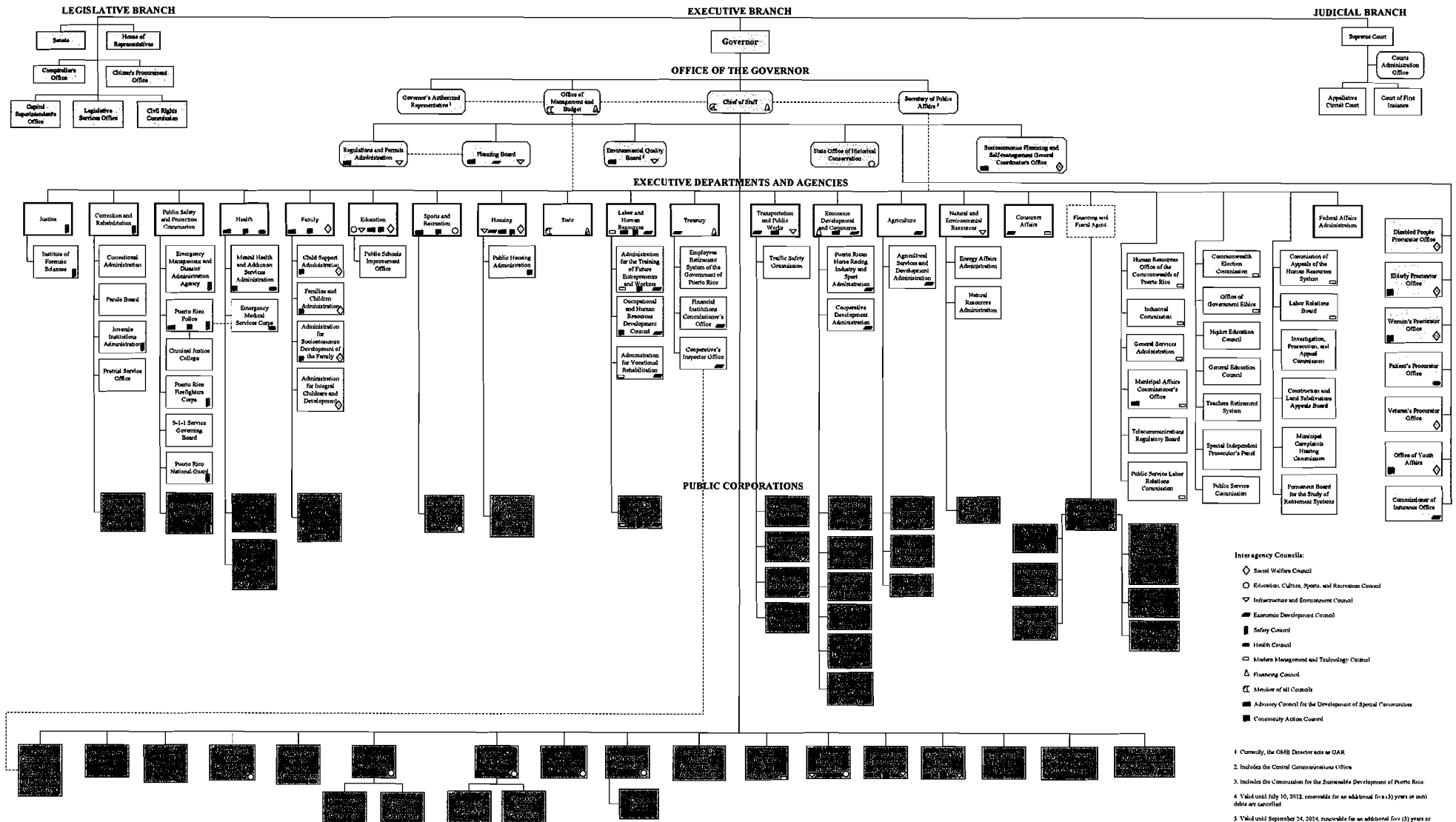
**José G. Dávila Matos**  
Director, Office of Management  
and Budget

**Alfredo Salazar Conde**  
President, Government  
Development Bank for  
Puerto Rico





# COMMONWEALTH OF PUERTO RICO



# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## Commonwealth of Puerto Rico

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2005

A Certificate of Achievement for Excellence in Financial  
Reporting is presented by the Government Finance Officers  
Association of the United States and Canada to  
government units and public employee retirement  
systems whose comprehensive annual financial  
reports (CAFRs) achieve the highest  
standards in government accounting  
and financial reporting.



A handwritten signature in black ink, appearing to read "Ronald J. Klein".

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emer".

Executive Director

## **FINANCIAL SECTION**



**KPMG LLP**  
American International Plaza  
Suite 1100  
250 Muñoz Rivera Avenue  
San Juan, PR 00918-1819

## **Independent Auditors' Report**

The Honorable Governor and Legislature  
Commonwealth of Puerto Rico  
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the year ended June 30, 2006, which collectively comprise the Commonwealth's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commonwealth's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Public Buildings Authority capital project fund or The Children's Trust special revenue fund (major funds), which represents 2% and 0%, respectively, of the assets and revenue of the governmental activities. We also did not audit the financial statements of the following activities, funds, and component units:

- Puerto Rico Public Housing Administration, Human Resources and Occupational Development Council, and the Office for the Administration of the Assets of the Urban Renovation and Housing Corporation of the Commonwealth of Puerto Rico, which collectively represent 16% and 3%, respectively, of the assets and revenue of the general fund and 6% and 3%, respectively, of the assets and revenue of the governmental activities,
- Public Buildings Authority special revenue and The Children Trust, Public Building Authority, and Puerto Rico Maritime Shipping Authority debt service funds, which collectively represent 7% and 4%, respectively, of the assets and revenue of the aggregate remaining fund information and 4% and 1%, respectively, of the assets and revenue of the governmental activities;
- The Additional Lottery System, which represents 66% and 39%, respectively, of the assets and revenue of the lotteries fund and 12% and 33%, respectively, of the assets and revenue of the business-type activities;
- Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund which collectively represent 3% and 2% respectively, of the assets and revenue of the aggregate remaining fund information and 21% and 3% of the assets and revenue of the business-type activities;
- The pension trust funds, which represents 71% and 91%, respectively, of the assets and revenue of the aggregate remaining fund information; and
- Entities identified in note 2 that are presented as discretely presented component units, which collectively represent 88% and 91%, respectively, of the assets and revenue of the aggregate discretely presented component units.

These financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for the activities, funds, and component units indicated above, are based on the reports of the other auditors.



We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Commonwealth's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico as of June 30, 2006, and the respective changes in financial position, and, where applicable, cash flows thereof and the respective budgetary comparison for the general fund for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in note 12, the Commonwealth adopted GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* as of June 30, 2006.

The management's discussion and analysis on pages 3 through 20 and the schedule of funding progress on pages 149 and 150 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The combining and individual fund financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. These combining and individual fund financial statements have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections listed in the table of content have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

KPMG LLP

August 1, 2007

Stamp No. 2221579 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.

## **COMMONWEALTH OF PUERTO RICO**

### **Management's Discussion and Analysis**

June 30, 2006

Management of the Commonwealth of Puerto Rico (the Commonwealth) provides this Management's Discussion and Analysis for the readers of the Commonwealth's basic financial statements. This narrative overview and analysis of the financial activities of the Commonwealth is for the fiscal year ended June 30, 2006, and is intended to provide an easily readable explanation of the information provided in the attached basic financial statements. We encourage readers to consider this information with the Commonwealth's basic financial statements that follow.

### **Financial Highlights – Primary Government**

#### ***Government-wide Highlights***

- The Commonwealth reported a deficit of \$16.4 billion as of June 30, 2006, a deterioration in the financial position of \$1.2 billion from last year's balances. The accumulated deficit is principally the result of the Commonwealth's practice of issuing debt and transferring such funds to its discretely presented component units in order for them to carry out the corresponding construction programs.
- The Commonwealth's total deficit increased by \$1.2 billion (an 7% increase) as a result of this year's operations. The governmental activities' deficit increased by \$1.3 billion (an 8% increase), while net assets of the business-type activities showed an increase of \$97 million (a 16% increase).
- The Commonwealth's governmental activities had total revenue of \$14.3 billion, which were exceeded by total expenses of \$15.8 billion, excluding transfers received from business-type activities amounting to \$243 million.
- The Commonwealth's business-type activities had total revenue of \$1.2 billion, which exceeded total expenses of \$903 million, excluding transfers made to the governmental activities amounting to \$243 million.

#### ***Fund Highlights***

- As of June 30, 2006, the Commonwealth's governmental funds reported a combined ending fund balance of \$411 million, an increase of \$18 million in comparison with the prior year, while the business-type activities increased by \$97 million to reach \$778 million.
- The general fund reported a deficit of \$384 million as of June 30, 2006, a decrease of \$120 million in comparison with the prior year.
- The unemployment insurance trust fund reported net assets of \$543 million while the lotteries fund reported a deficit of \$170 million. The deficit in the lottery funds was a result of the transfers of investments made to the general fund a few years ago.

#### ***Long-Term Debt***

- Total long-term obligations as of June 30, 2006 were \$27 billion, from which \$2 billion are due within one year. The long-term obligation of the governmental activities increased by \$2 billion (8%) to \$27 billion when compared to the prior year, while the business-type activities decreased by \$26 million (6%) to \$382 million. The increase in governmental activities' long-term obligations was mainly due to notes payables of the Department of the Treasury to cover operations needs.



## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis

June 30, 2006

#### Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Commonwealth's basic financial statements. The Commonwealth's basic financial statements include three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains additional required supplementary information in addition to the basic financial statements themselves. These components are described below:

#### *Basic Financial Statements*

The basic financial statements include two kinds of financial statements that present different views of the Commonwealth—the government-wide financial statements and the fund financial statements and combining major component units financial statements. These financial statements also include the notes to the basic financial statements that explain some of the information in the financial statements and provide more detail.

#### Government-wide Financial Statements

The government-wide financial statements provide a broad view of the Commonwealth's operations in a manner similar to a private sector business. The statements provide both short- and long-term information about the Commonwealth's financial position, which assists in assessing the Commonwealth's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenue and expenses connected with the fiscal year even if cash involved has not been received or paid. The government-wide financial statements include two statements:

- ***Statement of Net Assets*** – This presents all of the government's assets and liabilities with the difference between the two reported as net assets (deficit). Over time, increases or decreases in the Commonwealth's net assets (deficit) may serve as a useful indicator of whether the financial position of the Commonwealth is improving or deteriorating.
- ***Statement of Activities*** – This presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenue and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenue for each function of the Commonwealth.

Both of the above financial statements have separate sections for three different types of Commonwealth programs or activities. These three types of activities are as follows:

- ***Governmental Activities*** – The activities in this section are mostly supported by taxes and intergovernmental revenue (federal grants). Most services normally associated with Commonwealth government fall into this category, including general government, public safety, health, public housing and welfare, education, and economic development.
- ***Business-Type Activities*** – These functions normally are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. These business-type activities of the Commonwealth include the operations of the following major funds: unemployment insurance trust fund (administered by the Commonwealth Employment Security Bureau) and the lotteries.

## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis

June 30, 2006

- **Component Units** – These are organizations that are legally separate from the Commonwealth, but the Commonwealth is either financially accountable for them, or the nature and significance of their relationship with the Commonwealth are such that their exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. The Commonwealth has both blended and discretely presented component units.
- **Blended Component Units** – Although legally separate entities, these are in substance part of the primary government's operations. Therefore, data from blended component units are integrated into the appropriate funds for reporting purposes.

The Commonwealth's three blended component units are:

- Public Buildings Authority
  - Puerto Rico Maritime Shipping Authority
  - The Children's Trust
- **Discretely Presented Component Units** – These are operations for which the Commonwealth has financial accountability but they have certain independent qualities as well. For the most part, these entities operate similar to private sector businesses and the business-type activities described above. The Commonwealth's discretely presented component units are presented in two categories, major and nonmajor. This separation is determined by the relative size of the entities' assets, liabilities, revenue, and expenses in relation to the total of all component units.

The Commonwealth's 34 discretely presented nonmajor component units are combined into a single column for reporting in the fund financial statements. Complete financial statements of the individual component units can be obtained from their respective administrative offices. Addresses and other additional information about the Commonwealth's component units are presented in note 1 to the basic financial statements.

The Commonwealth's seven discretely presented major component units are:

- Government Development Bank for Puerto Rico
- Puerto Rico Highways and Transportation Authority
- Puerto Rico Electric Power Authority
- Puerto Rico Aqueduct and Sewer Authority
- Puerto Rico Infrastructure Financing Authority
- Puerto Rico Health Insurance Administration
- University of Puerto Rico

The government-wide financial statements can be found immediately following this discussion and analysis.



## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis

June 30, 2006

#### Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other states and local governments, uses fund accounting to help ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements focus on individual parts of the Commonwealth government, reporting the Commonwealth's operations in more detail than the government-wide financial statements. All of the funds of the Commonwealth can be divided into three categories. It is important to note that these fund categories use different accounting approaches and should be interpreted differently. The three categories of funds are the following:

- ***Governmental Funds Financial Statements*** – Most of the basic services provided by the Commonwealth are financed through governmental funds. Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of expendable resources. They also focus on the balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating the government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified-accrual basis of accounting. These statements provide a detailed short-term view of the Commonwealth's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the Commonwealth. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenue, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and the governmental activities. These reconciliations are presented on the page immediately following each governmental fund financial statement.

The Commonwealth has four major governmental funds. That is, each major fund is presented in a separate column in the governmental funds balance sheet and in the governmental funds statement of revenue, expenditures, and changes in fund balances. The Commonwealth's four major governmental funds are the general fund, The Children's Trust special revenue fund, the debt service fund, and the Public Buildings Authority capital projects fund. The remaining nonmajor governmental funds are grouped and presented in a single column in the governmental funds financial statements. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

- ***Proprietary Funds Financial Statements*** – These funds are used to show activities that operate more like those of commercial enterprises. Because these funds charge fees for services provided to outside customers including local governments, they are known as enterprise funds. Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. Like the government-wide financial statements, proprietary fund financial statements use the accrual basis of accounting. There is no reconciliation needed between the government-wide

## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis

June 30, 2006

financial statements for business-type activities and the proprietary fund financial statements. The Commonwealth has two major enterprise funds. As previously mentioned, they are the operations of the unemployment insurance trust fund (administered by the Commonwealth's Employment Security Bureau) and the lotteries. Other nonmajor proprietary funds are grouped and presented in a separate column in the proprietary funds financial statements. The basic proprietary funds financial statements can be found immediately following the governmental fund financial statements.

- ***Fiduciary Funds and Similar Component Units Financial Statements*** – These funds are used to account for resources held for the benefit of parties outside the Commonwealth government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the Commonwealth's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. They use the accrual basis of accounting. The Commonwealth's fiduciary funds are the pension trust funds (three separate retirement systems for employees, which are fiduciary component units of the Commonwealth), and the agency funds (which account for the assets held for distribution by the Commonwealth as an agent for other governmental units, other organizations, or individuals). The basic fiduciary funds and similar component units' financial statements can be found immediately following the proprietary funds financial statements.

### **Component Units Financial Statements**

As mentioned above, these are operations for which the Commonwealth has financial accountability, but they have certain independent qualities as well, and they operate similar to private-sector businesses. The government-wide financial statements present information for the component units in a single column on the statement of net assets. Also, some information on the statement of changes in net assets is aggregated for component units. The combining statements of net assets and the combining statement of activities provide detail for each major component unit and the nonmajor component units in aggregate. The basic combining financial statements for major component units can be found immediately following the fiduciary funds financial statements.

### **Notes to Basic Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the basic financial statements can be found immediately following the component units' financial statements.

### **Required Supplementary Information**

The basic financial statements include within its notes a section of required supplementary information. This section includes information of funding progress for the Commonwealth's three separate retirement systems.

### **Government-Wide Financial Analysis**

#### ***Net Assets***

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. Total assets and total liabilities of the Commonwealth's primary government at June 30, 2006 amounted to

## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis

June 30, 2006

\$14.9 billion and \$31.3 billion, respectively, for a net deficit of \$16.4 billion, compared to a \$15.2 billion net deficit at the beginning of the current year, as restated.

A portion of the Commonwealth's net assets (deficit) reflects its investment in capital assets such as land, buildings, and equipment, less any related debt used to acquire those assets that are still outstanding. The Commonwealth uses these capital assets to provide services to its residents; consequentially, these assets are not available for future spending. Although the Commonwealth's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Commonwealth's net assets (deficit) represents resources that are subject to external restrictions on how they may be used. An otherwise positive remaining balance would be used to meet the Commonwealth's ongoing obligations to its residents and creditors. Internally imposed designations of resources are not presented as restricted net assets. At the end of the current fiscal year, the Commonwealth is able to report positive balances in two categories of net assets, and a deficit, both for the government as a whole, as well as for its separate governmental and business-type activities.

As explained earlier, the net deficit of the primary government primarily results from the Commonwealth's practice of issuing debt and transferring such funds to the component units so that they can carry out the construction projects. The primary government retains the debt while the component units report the corresponding asset financed by such debt.

Total assets increased by \$1.5 billion during fiscal year 2006 when compared to the prior fiscal year. The key elements for this increase are as follows:

- Restricted cash increased by \$647 million when compared to the prior year. The increase was due to approximately \$250 million in cash restricted for tax revenue anticipation notes, and an overall increase in cash restricted for the payment of other long-term debt.
- Taxes receivable increased \$120 million when compared to the prior year.
- Additions of capital assets and depreciation expense amounted to \$816 million and \$223 million, respectively.

# **COMMONWEALTH OF PUERTO RICO**

## **Management's Discussion and Analysis**

June 30, 2006

Total liabilities increased \$3 billion during the current fiscal year when compared to the prior fiscal year. The key elements for this increase are mostly due to the net increase in debt issued of \$1.64 billion, which consisted of issuances during fiscal year 2006 of Commonwealth bonds and notes payable amounting to \$141 million and \$3.2 billion, respectively, offset by repayments of such debt in the amount of \$209 million and \$140 million, respectively. Increases were also experienced in the net pension obligation of \$261 million and accounts payable and tax revenue anticipation notes of \$298 million and \$250 million, respectively.

### **Commonwealth's Net Assets – Primary Government**

**June 30, 2006**

(expressed in thousands)

	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
Current assets	\$ 3,665,245	939,895	4,605,140
Capital assets	7,183,178	1,008	7,184,186
Other assets	2,817,053	255,993	3,073,046
<b>Total assets</b>	<b>\$ 13,665,476</b>	<b>1,196,896</b>	<b>14,862,372</b>
Current liabilities	\$ 6,378,707	149,673	6,528,380
Noncurrent liabilities	24,496,332	269,723	24,766,055
<b>Total liabilities</b>	<b>\$ 30,875,039</b>	<b>419,396</b>	<b>31,294,435</b>
Invested in capital assets, net of related debt	\$ 3,485,882	1,008	3,486,890
Restricted	280,078	947,507	1,227,585
Unrestricted	(20,975,523)	(171,015)	(21,146,538)
<b>Total net assets (deficit)</b>	<b>\$ (17,209,563)</b>	<b>777,500</b>	<b>(16,432,063)</b>

# COMMONWEALTH OF PUERTO RICO

## Management's Discussion and Analysis

June 30, 2006

### Commonwealth's Net Assets – Primary Government

June 30, 2005

(expressed in thousands)

	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
Current assets	\$ 2,897,994	886,219	3,784,213
Capital assets	7,119,033	1,367	7,120,400
Other assets	2,187,383	222,748	2,410,131
<b>Total assets</b>	<b>\$ 12,204,410</b>	<b>1,110,334</b>	<b>13,314,744</b>
Current liabilities	\$ 5,268,743	142,818	5,411,561
Noncurrent liabilities	22,852,456	296,666	23,149,122
<b>Total liabilities</b>	<b>\$ 28,121,199</b>	<b>439,484</b>	<b>28,560,683</b>
Invested in capital assets, net of related debt	\$ 3,623,158	847	3,624,005
Restricted	296,692	872,215	1,168,907
Unrestricted	(19,836,639)	(202,212)	(20,038,851)
<b>Total net assets (deficit)</b>	<b>\$ (15,916,789)</b>	<b>670,850</b>	<b>(15,245,939)</b>

### Changes in Net Assets

The Commonwealth's net deficit increased by \$1.2 billion or 8% from last year's total net deficit. Approximately 52% of the Commonwealth's total revenue came from taxes, while 29% resulted from grants and contributions (primarily federal financial assistance). Charges for various goods and services provided represented 13% of the total revenue. The Commonwealth's expenses cover a range of services. The largest expenses were for education, public housing and welfare, general government, and public safety. In 2006, governmental activities' expenses exceeded program revenue by \$10.5 billion, resulting in the use of \$9.2 billion in general revenue (mostly taxes) and transfers. On the other hand, program revenue from business-type activities in 2006 exceeded expenses by approximately \$306 million. In addition, the business-type activities had unrestricted investments earnings of \$33 million and transfer to the governmental activities amounting to \$243 million.

Governmental activities decreased the Commonwealth's net assets by \$1.2 billion, which is \$1.7 billion less than \$2.9 billion experienced in the prior year. The Commonwealth made efforts to decrease overall expenses; these efforts resulted in a decrease \$1.2 billion, but revenues were still lower than total expenses. The Commonwealth implemented the 5.5% sales and use tax during fiscal year 2007. This sales and use tax results in higher tax revenues. The Commonwealth expects that the effort to decrease expenses and the increase in tax revenue with the sales and use tax will eliminate or significantly lower the deficit in future years.

Business-type activities increased the Commonwealth's net assets by \$97 million. The two main factors that contributed to the increase in net assets were the reduction of \$30 million in the operating expenses in lottery funds and the increase in nonoperating revenue of \$37.3 million of contributions from federal government on unemployment fund, water pollution control and treatment revolving loan funds.

**COMMONWEALTH OF PUERTO RICO**

Management's Discussion and Analysis

June 30, 2006

**Commonwealth of Puerto Rico's Changes in Net Assets – Primary Government**  
**Year ended June 30, 2006**  
(expressed in thousands)

	<b>Governmental activities</b>	<b>Business-type activities</b>	<b>Total</b>
<b>Revenue:</b>			
Program revenue:			
Charges for services	\$ 828,993	1,149,426	1,978,419
Operating grants and contributions	4,365,711	59,613	4,425,324
Capital grants and contributions	100,990	—	100,990
	<u>5,295,694</u>	<u>1,209,039</u>	<u>6,504,733</u>
General revenue:			
Income taxes	6,255,391	—	6,255,391
Excise taxes	2,013,998	—	2,013,998
Other taxes	15,145	—	15,145
Revenue from component units	68,745	—	68,745
Other	601,225	33,165	634,390
	<u>8,954,504</u>	<u>33,165</u>	<u>8,987,669</u>
Total revenue	<u>14,250,198</u>	<u>1,242,204</u>	<u>15,492,402</u>
<b>Expenses:</b>			
General government	2,844,494	—	2,844,494
Public safety	2,217,294	—	2,217,294
Health	1,422,813	—	1,422,813
Public housing and welfare	3,287,559	—	3,287,559
Education	4,110,669	—	4,110,669
Economic development	564,447	—	564,447
Intergovernmental	440,390	—	440,390
Interest and other	882,163	25,043	907,206
Lotteries	—	670,425	670,425
Unemployment	—	207,483	207,483
Total expenses	<u>15,769,829</u>	<u>902,951</u>	<u>16,672,780</u>
(Decrease) increase in net assets before transfers	(1,519,631)	339,253	(1,180,378)
Transfers	<u>242,642</u>	<u>(242,642)</u>	<u>—</u>
(Decrease) increase in net assets	(1,276,989)	96,611	(1,180,378)
Net assets (deficit), beginning of year (as restated)	<u>(15,932,574)</u>	<u>680,889</u>	<u>(15,251,685)</u>
Net assets (deficit), end of year	<u>\$ (17,209,563)</u>	<u>777,500</u>	<u>(16,432,063)</u>

**COMMONWEALTH OF PUERTO RICO**

Management's Discussion and Analysis

June 30, 2006

**Commonwealth of Puerto Rico's Changes in Net Assets – Primary Government**  
**Year ended June 30, 2005**  
(expressed in thousands)

	<u>Governmental activities</u>	<u>Business-type activities</u>	<u>Total</u>
Revenue:			
Program revenue:			
Charges for services	\$ 702,691	1,187,009	1,889,700
Operating grants and contributions	4,096,204	22,315	4,118,519
Capital grants and contributions	121,083	—	121,083
	<u>4,919,978</u>	<u>1,209,324</u>	<u>6,129,302</u>
General revenue:			
Income taxes	5,526,006	—	5,526,006
Excise taxes	2,101,216	—	2,101,216
Other taxes	7,128	—	7,128
Revenue from component units	474,069	—	474,069
Other	648,083	32,284	680,367
	<u>8,756,502</u>	<u>32,284</u>	<u>8,788,786</u>
Total revenue	<u>13,676,480</u>	<u>1,241,608</u>	<u>14,918,088</u>
Expenses:			
General government	1,827,816	—	1,827,816
Public safety	2,580,951	—	2,580,951
Health	2,364,110	—	2,364,110
Public housing and welfare	3,443,886	—	3,443,886
Education	5,000,686	—	5,000,686
Economic development	1,006,945	—	1,006,945
Interest and other	845,556	32,437	877,993
Lotteries	—	699,407	699,407
Unemployment	—	197,967	197,967
Total expenses	<u>17,069,950</u>	<u>929,811</u>	<u>17,999,761</u>
(Decrease) increase in net assets before transfers	(3,393,470)	311,797	(3,081,673)
Transfers	<u>492,776</u>	<u>(492,776)</u>	<u>—</u>
Decrease in net assets	(2,900,694)	(180,979)	(3,081,673)
Net assets (deficit), beginning of year (as restated)	<u>(13,016,095)</u>	<u>851,829</u>	<u>(12,164,266)</u>
Net assets (deficit), end of year as presented in 2005	<u>\$ (15,916,789)</u>	<u>670,850</u>	<u>(15,245,939)</u>

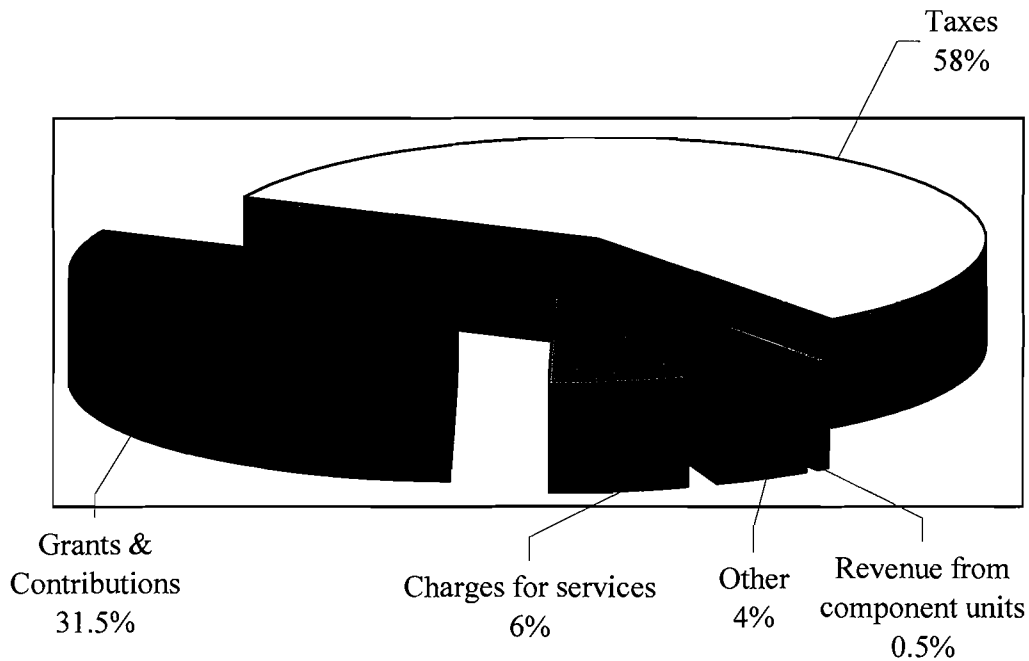


**COMMONWEALTH OF PUERTO RICO**

Management's Discussion and Analysis

June 30, 2006

**Revenue – Governmental Activities  
Year ended June 30, 2006**



**Expenses – Governmental Activities  
Year ended June 30, 2006  
(expressed in thousands)**

<b>Functions</b>	<b>Expenses</b>
Primary government:	
Governmental activities:	
General government	\$ 2,844,494
Public safety	2,217,294
Health	1,422,813
Public housing and welfare	3,287,559
Education	4,110,669
Economic development	564,447
Intergovernmental	440,390
Interest and other	882,163
Total governmental activities	<u>\$ 15,769,829</u>



**COMMONWEALTH OF PUERTO RICO**

**Management's Discussion and Analysis**

June 30, 2006

**Governmental Activities**

Governmental activities increased the Commonwealth's net deficit to \$17.2 billion. The decrease in net assets by the business-type activities is explained below. A comparison of the cost of services by function for the Commonwealth's governmental activities is shown below, along with the revenue used to cover the net expenses of the governmental activities (expressed in thousands).

**Governmental Activities – Expenses Net of Program Revenue**  
**Year ended June 30, 2006**  
(expressed in thousands)

Net (expense) revenue:	
General government	\$ (2,025,403)
Public safety	(2,061,914)
Health	(662,913)
Public housing and welfare	(804,088)
Education	(3,111,106)
Economic development	(486,887)
Intergovernmental	(439,661)
Interest and other	<u>(882,163)</u>
Total governmental activities expenses, net program revenue	(10,474,135)
General revenue:	
Taxes	8,284,534
Revenue from component units	68,745
Transfers from business-type activities	242,642
Other revenue	<u>601,225</u>
Increase in governmental activities net deficit	<u><u>\$ (1,276,989)</u></u>

# COMMONWEALTH OF PUERTO RICO

## Management's Discussion and Analysis

June 30, 2006

### Expenses and Program Revenue – Governmental Activities Year ended June 30, 2006 (expressed in thousands)

Functions	Expenses	Charges for services
Primary government:		
Governmental activities:		
General government	\$ 2,844,494	576,791
Public safety	2,217,294	58,284
Health	1,422,813	105,264
Public housing and welfare	3,287,559	29,534
Education	4,110,669	2,423
Economic development	564,447	55,968
Intergovernmental	440,390	729
Interest and other	882,163	—
Total governmental activities	\$ 15,769,829	828,993

### *Business-Type Activities*

The business-type activities increased the Commonwealth's net assets by \$97 million. This resulted from a reduction of lottery awards of \$30 million and contributions of federal government of \$37.3 million explained previously.

### **Financial Analysis of the Commonwealth's Individual Funds**

As noted earlier, the Commonwealth uses fund accounting to help ensure and demonstrate compliance with finance-related legal requirements.

### *Governmental Funds*

The focus of the Commonwealth's governmental funds is to provide information on near-term inflows, outflows, and balances of expendable resources. Such information is useful in assessing the Commonwealth's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. As of the end of fiscal year 2006, the Commonwealth's governmental funds reported combined ending fund balance of \$411 million, an increase of \$18 million in comparison with the prior year. Although the expenditures exceeded the revenues by \$1.8 billion, the result of the other financing sources amounting to \$1.8 billion led to a break-even situation in the fund balance of the governmental funds. This year the excess of expenditures over revenue decreased by \$1.1 billion compared with the prior year. There is \$844 million of fund balance reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate contracts and purchase orders of the prior fiscal year, or (2) for a variety of other restricted purposes.

The general fund is the chief operating fund of the Commonwealth. At the end of the current fiscal year, unreserved fund deficit of the general fund was \$1.1 billion, while the total fund balance has a total deficit of

## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis

June 30, 2006

\$384 million. The fund balance of the Commonwealth's general fund increased by \$120 million as a result of the current fiscal year's change in financial position. This is a 24% increase when compared to total fund balance reported in fiscal year 2005. Also, see additional related comments in the following section titled General Fund Budgetary Highlights.

The debt service fund is the fund in which the Commonwealth accumulates the resources for the payment of the long-term debt. At end of the year the fund balance increased by \$41 million due to the transfers received from the general fund. Cash and cash equivalents increased by \$20 million or 2% compared with the prior year mainly due to investments of the transfers received from the general fund for the payment of debt.

The PBA capital project fund received resources only from transfers from other funds and had expenditures of \$176 million, which resulted in a deficit of \$32 million for the fund. The fund total assets decreased \$153 million or 73% compared with the prior year because of a decrease in restricted cash in commercial banks, which was used to acquire capital assets.

The fund balance of The Children's Trust special revenue fund had an increase of \$17 million. The increase was mainly due to \$54 million transferred from GDB from investments related to QZAB bonds.

Although the revenue of other governmental funds (nonmajor) increased by \$18 million or 18% during the year compared with the prior year, the expenditures decreased by \$387 million or 41%, the most significant reduction in expenditures was noted in general government, education, capital outlays, and public safety of \$188 million, \$128 million, \$48 million, and \$43 million, respectively. Nevertheless the fund had \$408 million in other financing sources that led to a net decrease of \$23 million in the fund balance. Total assets of nonmajor funds increased by \$386 million or 45% compared with the prior year. The most significant contributions to this increase arose from the cash and cash equivalents, due from other funds and restricted cash and cash equivalents by \$318 million or 56%, \$39 million or 34%, and \$25 million or 22%, respectively.

#### ***Proprietary Funds***

The Commonwealth's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail. As discussed in the business-type activities above, the Commonwealth's net assets increased by \$97 million as a result of operations in the proprietary funds. This resulted from a \$21 million increase in net assets by the lotteries fund, an increase in net assets of \$41 million by the unemployment insurance trust fund, and an increase of net assets of \$35 million by the Commonwealth's other nonmajor enterprise funds.

#### **General Fund Budgetary Highlights**

Actual revenues were less than final budgeted revenue by \$365 million. The net decrease was primarily attributed to unachieved income and excise taxes of \$208 million and \$117 million, respectively, in comparison with the budgeted amounts. The reduction is attributable to the current economic slowdown, caused primarily by the current price of oil and its derivatives being at a historically high level, the government's fiscal crisis, which resulted in a two-week shutdown of nonessential government services, and the uncertainty surrounding the enactment of the tax and fiscal reform to address the government's fiscal crisis.

The actual expenditures reflected an increase of \$388 million when compared to the final budgeted amounts. The excess in expenditures was predominantly caused by the Department of Education with \$137 million, the Office

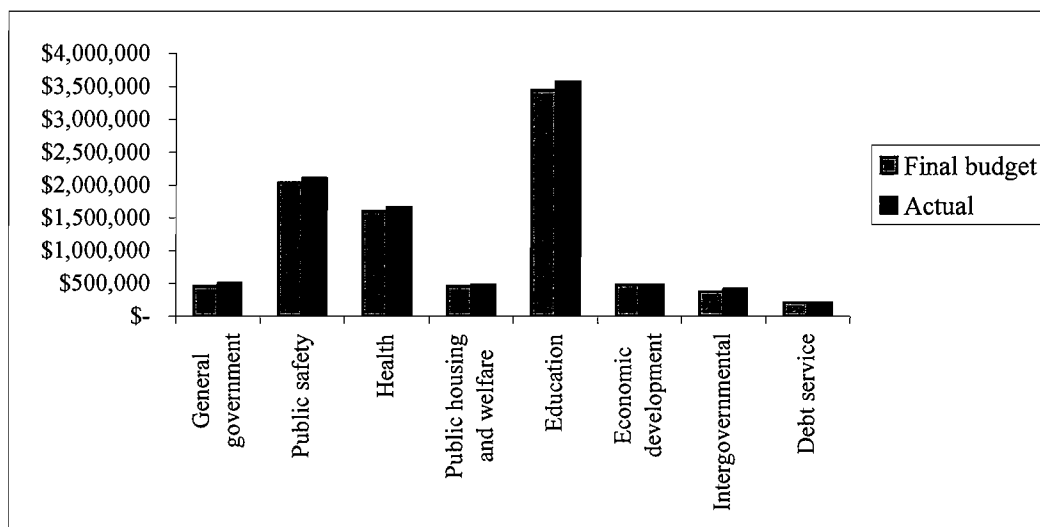
## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis

June 30, 2006

of Management and Budget with \$45 million, the Municipal Service Administration with \$32.5 million, the Correction Administration with \$27 million, the Department of Health with \$26 million, the Puerto Rico Health Insurance Administration with \$21 million, and the Puerto Rico General Court of Justice with \$19 million. Most of these variances were financed through the use of borrowings which provided resources of \$1,345 million. These financing resources came primarily from Government Development Bank for Puerto Rico loans of \$1,109 million and proceeds generated by the issuance of the Commonwealth's Public Improvement Refunding of \$100 million.

### Expenditures – General Fund Budget vs. Actual Year ended June 30, 2006 (expressed in thousands)



As of June 30, 2006, there was an excess of expenditures and other financing uses over revenue and other financing sources of \$461 million.

### Capital Assets and Debt Administration

#### *Capital Assets*

The Commonwealth's investment in capital assets for its governmental and business-type activities as of June 30, 2006 amounts to \$9.7 billion, less accumulated depreciation of \$2.5 billion, leaving a book value of \$7.2 billion. This investment in capital assets includes land, buildings, building improvements, equipment, and construction in progress as infrastructure.

The net book value of capital assets at June 30, 2006 is distributed by function/activity in the following proportions: general government, 42%; public safety, 5%; health, 1%; public housing and welfare, 33%; education, 7%; and economic development 12%. Actual expenditures to purchase or construct capital assets were approximately \$816 million for the year. Depreciation charges for the year totaled \$223 million.

## COMMONWEALTH OF PUERTO RICO

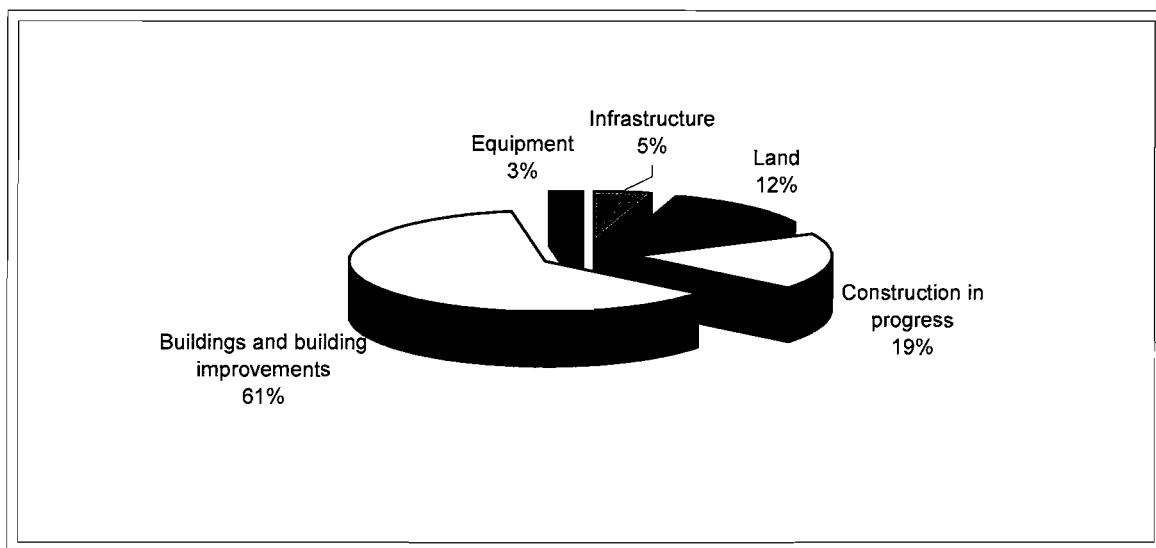
### Management's Discussion and Analysis

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The infrastructure assets representing items that are normally immovable and of value only to the Commonwealth as roads, highways, bridges, toll facilities, water and sewer systems, lighting production, transmission and distribution systems, and similar items are principally owned by the component units of the Commonwealth. Therefore, the infrastructure assets are reported within depreciable capital assets under the discretely presented component units column. Additional information on the Commonwealth's capital assets can be found in note 12 to the basic financial statements that accompany this report.

#### Commonwealth's Capital Assets – Primary Government Year ended June 30, 2006 (expressed in thousands)

	Governmental activities	Business-type activities
Land	\$ 848,443	—
Construction in progress	1,381,823	—
Buildings and building improvements, net	4,395,150	—
Equipment, net	200,213	1,008
Infrastructure, net	357,549	—
Total capital assets	\$ 7,183,178	1,008



#### Debt Administration

General obligation bonds are backed by the full faith and credit of the Commonwealth, including the Commonwealth's power to levy additional taxes to help ensure repayment of the debt.

The Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit, and taxing power of the Commonwealth are not to be issued if

## COMMONWEALTH OF PUERTO RICO

### Management's Discussion and Analysis

June 30, 2006

the amount of the principal of, and interest on, such bonds and notes and on all such bonds and notes issued thereafter which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceed 15% of the average annual revenue raised under the provisions of Commonwealth legislation and conveyed into the Treasury in the two fiscal years preceding the then current fiscal year. Section 2, Article VI of the Constitution of the Commonwealth does not limit the amount of debt that the Commonwealth may guarantee as long as the 15% limitation is not exceeded. At June 30, 2006, the Commonwealth is in compliance with the debt limitation requirement.

Moody's lowered the rating on the Commonwealth's outstanding general obligation bonds from "Baa1" to "Baa2" earlier in the year. Standard & Poor's Rating Services (S&P) had also lowered its rating on the Commonwealth's general obligation bonds earlier in the year.

On May 22, 2007, S&P lowered its long-term rating on the Commonwealth's general obligation debt to 'BBB-' from 'BBB', reflecting a long history of structural imbalance and the ongoing difficulties anticipated with further efforts to reduce the accrued deficit. The outlook was defined as stable.

The rating on the appropriation debt, typically rated one notch below the general obligation debt, has not been lowered, reflecting the improvements that have been made. S&P does not believe that Puerto Rico's appropriation credit is speculative grade.

S&P noted that Puerto Rico's debt, which is already high, is likely to increase. Although a major new revenue source of a 5.5% sales and use tax was added in the current fiscal year, balances remain difficult to achieve, requiring expense cuts and use of one-time revenue sources. Gap forecast suggest that balance will not be achieved until 2010 and that forecast is based on the expectation of flat expense growth.

Ratings reflect only the respective views of the rating agencies and an explanation of the significance of each rating may be obtained only from the respective rating agency.

The Commonwealth's total long-term obligations increased by \$2 billion during the current fiscal year, representing an 8% increase. Additional information on the Commonwealth's long-term obligations can be found in note 14 to the basic financial statements of this report.

#### **Economic Factors and Next Year's Budgets and Rates**

The unemployment rate for the Commonwealth of Puerto Rico is currently 11.7%, which is an increase from a rate of 10.6% a year ago.

Based on the projections of the Puerto Rico Planning Board, the Puerto Rico economy is expected to reflect a real growth of 1.2% for the fiscal year 2006.

In an effort to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Executive Branch and the Legislative Assembly enacted and the Governor signed legislation providing for tax reform and fiscal reforms. The tax reform legislation is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based sales tax. The fiscal reform legislation is aimed at limiting expenditures in relation to past spending rates and stabilizing expenditure growth at a level below that of recurring revenues.

## **COMMONWEALTH OF PUERTO RICO**

### **Management's Discussion and Analysis**

June 30, 2006

On July 4, 2006 was approved Act No. 117 (Act 117) which amends the Puerto Rico Internal Revenue Code of 1994 (the PR Code) to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the Central Government Sales Tax). Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5% (the Municipal Sales Tax and, together with the Central Government Sales Tax, the Sales Tax). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods) and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets. Act 117 repeals the 5% general excise tax imposed on imported goods and on goods manufactured in Puerto Rico. Certain items, such as fuel, crude oil and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items and will not be subject to the Sales Tax. The effective date of the repeal of the 5% general excise tax was October 17, 2006 pursuant to Act 229.

The Sales Tax will be effective on November 15, 2006. Municipalities, however, were authorized to implement the Municipal Sales Tax starting on July 1, 2006, and some have already done so. The revenues derived from the Sales Tax will be distributed as follows: (i) municipal governments will retain 1.3% of the Sales Tax, (ii) the Financial Assistance Fund, created by Act No. 91 on May 13, 2006, will receive 1% of the Sales Tax, and (iii) the General Fund will receive 4.7% of the Sales Tax. The revenues to be generated by the Sales Tax will be partly offset by the partial elimination of the 5% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provides for special income tax rates with respect to certain transactions occurring on and between July 1, 2006 and December 31, 2006. These special tax rates will apply to eligible dividends declared by domestic corporations or partnerships and "built-in" gains associated with capital assets held for periods in excess of six months, as well as certain withdrawals from retirement accounts. These special tax rates are only available for transactions in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. In the case of resident corporations and partnerships, these special tax rates apply only to real property located in Puerto Rico.

The consolidated budget for the fiscal year 2005-06 amounts to \$21.8 billion. From this amount, \$15.9 billion is assigned to operating expenses, \$3.3 billion to a permanent capital improvements program, and \$2.7 billion for the debt service.

#### **Requests for Information**

This financial report is designed to provide a general overview of the Commonwealth's finances for all of the Commonwealth's residents, taxpayers, customers, investors, and creditors. This financial report seeks to demonstrate the Commonwealth's accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Department of the Treasury of the Commonwealth of Puerto Rico, Área de Contabilidad Central, P.O. Box 9024140, San Juan, Puerto Rico 00902-4140.



COMMONWEALTH OF PUERTO RICO

Statement of Net Assets (Deficit)

June 30, 2006

(In thousands)

	Primary Government			Component units
	Governmental activities	Business- type activities	Totals primary government	
Assets:				
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ 522,056	87,191	609,247	2,788,852
Cash and cash equivalents in governmental banks	1,035,991	747,049	1,783,040	635,650
Investments	188,169	—	188,169	2,474,477
Receivables, net of allowance for uncollectibles:				
Taxes	1,209,961	—	1,209,961	—
Unemployment and other insurance premiums	—	64,800	64,800	109,780
Intergovernmental	300,104	—	300,104	41,001
Accounts	94,459	—	94,459	787,415
Loans	6,790	—	6,790	5,009,012
Accrued interest	12,421	2,853	15,274	332,243
Other	108,200	13,866	122,066	116,292
Due from:				
Primary government	—	—	—	280,148
Component units	125,395	7,605	133,000	2,378,592
Other governmental entities	13,866	—	13,866	201,089
Internal balances	(16,531)	16,531	—	—
Inventories	23,490	—	23,490	338,127
Prepaid expenses	7,269	—	7,269	56,101
Other assets	33,605	—	33,605	—
Restricted assets:				
Cash and cash equivalents in commercial banks and U.S. Treasury	692,637	—	692,637	828,368
Cash and cash equivalents in governmental banks	1,896,060	—	1,896,060	797,044
Investments and other restricted assets	—	33,473	33,473	6,787,159
Long-term investments	—	—	—	1,470,098
Long-term receivables from:				
Loans	—	—	—	123,683
Interest-bearing deposits with other banks	—	—	—	6,659
Long-term amounts due from:				
Primary government	—	—	—	92,754
Component units	—	180,450	180,450	17,303
Other governmental entities	—	—	—	32,663
Other	—	—	—	531
Real estate held for sale	48,705	—	48,705	212,097
Deferred expenses and other assets	179,651	42,070	221,721	453,430
Capital assets (net of accumulated depreciation):				
Land and other nondepreciable assets	2,230,266	—	2,230,266	8,774,212
Depreciable assets	4,952,912	1,008	4,953,920	17,836,723
Total assets	\$ 13,665,476	1,196,896	14,862,372	52,981,503

See accompanying notes to basic financial statements.



**COMMONWEALTH OF PUERTO RICO**

Statement of Net Assets (Deficit)

June 30, 2006

(In thousands)

	Primary Government			Component units
	Governmental activities	Business- type activities	Totals primary government	
Liabilities:				
Accounts payable and accrued liabilities	\$ 2,051,175	6,569	2,057,744	2,315,969
Deposits and escrow liabilities	—	—	—	6,645,956
Tax refunds payable	264,289	—	264,289	—
Due to:				
Primary government	—	—	—	126,402
Component units	258,251	—	258,251	656,136
Other governmental entities	19,103	—	19,103	37,610
Securities lending transactions and reverse repurchase agreements	—	—	—	792,844
Interest payable	535,336	—	535,336	542,251
Deferred revenue	124,633	30,786	155,419	126,555
Tax revenue anticipation notes payable	1,050,037	—	1,050,037	—
Due to primary government – long-term portion	—	—	—	187,048
Due to component units – long-term portion	—	—	—	1,731,685
Deferred revenue – long-term portion	—	—	—	23,385
Insurance benefits payable	—	70,973	70,973	—
Liability for automobile accident insurance and workers' compensation claims	—	—	—	811,310
Liabilities payable within one year:				
Commonwealth appropriation bonds	84,190	—	84,190	4,031
Bonds	253,559	—	253,559	777,337
Notes	625,373	—	625,373	1,557,936
Capital leases	4,476	—	4,476	—
Compensated absences	962,323	3,857	966,180	232,701
Lottery prizes	—	37,488	37,488	—
Other long-term liabilities	145,962	—	145,962	152,254
Liabilities payable after one year:				
Commonwealth appropriation bonds	2,558,004	—	2,558,004	1,021,097
Bonds	12,125,648	—	12,125,648	18,733,632
Notes	3,194,405	—	3,194,405	2,764,437
Capital leases	140,025	—	140,025	—
Net pension obligation	4,740,806	—	4,740,806	—
Compensated absences	721,630	3,508	725,138	324,783
Lottery prizes	—	266,215	266,215	—
Other long-term liabilities	1,015,814	—	1,015,814	331,520
Total liabilities	\$ 30,875,039	419,396	31,294,435	39,896,879
Net assets (deficit):				
Invested in capital assets, net of related debt	\$ 3,485,882	1,008	3,486,890	10,815,299
Restricted for:				
Trust – nonexpendable	—	—	—	1,387,419
Capital projects	—	247,741	247,741	653,115
Debt service	192,490	—	192,490	909,008
Payment of unemployment and related benefits	—	699,766	699,766	—
Affordable housing and related loan insurance programs	87,588	—	87,588	781,131
Student loans and other educational purposes	—	—	—	17,321
Other	—	—	—	150,790
Unrestricted (deficit)	(20,975,523)	(171,015)	(21,146,538)	(1,629,459)
Total net assets (deficit)	\$ (17,209,563)	777,500	(16,432,063)	13,084,624

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Activities  
Year ended June 30, 2006  
(In thousands)

Functions	Expenses	Program revenue			Net (Expense) Revenue and Changes in Net Assets			
		Charges for services	Operating grants and contributions	Capital grants and contributions	Primary Government		Total	Component units
					Governmental activities	Business-type activities		
Primary government:								
Governmental activities:								
Current:								
General government	\$ 2,844,494	576,791	242,300	—	(2,025,403)	—	(2,025,403)	—
Public safety	2,217,294	58,284	92,550	4,546	(2,061,914)	—	(2,061,914)	—
Health	1,422,813	105,264	654,586	50	(662,913)	—	(662,913)	—
Public housing and welfare	3,287,559	29,534	2,357,917	96,020	(804,088)	—	(804,088)	—
Education	4,110,669	2,423	996,766	374	(3,111,106)	—	(3,111,106)	—
Economic development	564,447	55,968	21,592	—	(486,887)	—	(486,887)	—
Intergovernmental	440,390	729	—	—	(439,661)	—	(439,661)	—
Interest and other	882,163	—	—	—	(882,163)	—	(882,163)	—
Total governmental activities	15,769,829	828,993	4,365,711	100,990	(10,474,135)	—	(10,474,135)	—
Business-type activities:								
Lotteries	670,425	868,347	—	—	—	197,922	197,922	—
Unemployment	207,483	251,254	35,418	—	—	43,771	43,771	—
Other	25,043	29,825	24,195	—	—	64,395	64,395	—
Total business-type activities	902,951	1,149,426	59,613	—	—	306,088	306,088	—
Total primary government	\$ 16,672,780	1,978,419	4,425,324	100,990	(10,474,135)	306,088	(10,168,047)	—
Component units:								
Government Development Bank for Puerto Rico	\$ 688,830	593,004	—	156,365	—	—	—	60,539
Puerto Rico Highway and Transportation Authority	904,973	245,109	—	83,768	—	—	—	(576,096)
Puerto Rico Electric Power Authority	3,780,539	3,716,082	—	—	—	—	—	(64,457)
Puerto Rico Aqueduct and Sewer Authority	841,300	469,939	8,789	—	—	—	—	(362,572)
Puerto Rico Infrastructure Financing Authority	126,469	—	—	—	—	—	—	(126,469)
Puerto Rico Health Insurance Administration	1,561,451	452,965	—	—	—	—	—	(1,108,486)
University of Puerto Rico	1,237,194	166,023	238,149	—	—	—	—	(833,022)
Other component units	2,485,772	1,829,229	37,742	24,254	—	—	—	(594,547)
Total component units	\$ 11,626,528	7,472,351	284,680	264,387	—	—	—	(3,605,110)
General revenue:								
Taxes:								
Income taxes					\$ 6,255,391	—	6,255,391	—
Excise taxes					2,013,998	—	2,013,998	363,091
Other taxes					15,145	—	15,145	—
Revenue from global tobacco settlement agreement					66,796	—	66,796	—
Revenue from Tourism Company of Puerto Rico					23,200	—	23,200	—
Revenue from Governing Board of 9-1-1 Services					8,828	—	8,828	—
Revenue from State Insurance Fund Corporation					36,717	—	36,717	—
Grants and contributions not restricted to specific programs					196,721	—	196,721	77,912
Special Item-Defeased QZAB bonds					(2,485)	—	(2,485)	—
Payments from primary government					—	—	—	2,427,161
Unrestricted investment earnings					117,080	33,165	150,245	79,773
Gain on sale of assets					19,588	—	19,588	8,737
Other					203,525	—	203,525	20,346
Transfers					242,642	(242,642)	—	—
Total general revenue and transfers					9,197,146	(209,477)	8,987,669	2,977,020
Change in net assets					(1,276,989)	96,611	(1,180,378)	(628,090)
Net assets – beginning of year (as restated)					(15,932,574)	680,889	(15,251,685)	13,712,714
Net assets – end of year					\$ (17,209,563)	777,500	(16,432,063)	13,084,624

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Balance Sheet – Governmental Funds

June 30, 2006

(In thousands)

Assets	General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
Cash and cash equivalents in commercial banks	\$ 36,017	—	48,742	—	437,297	522,056
Cash and cash equivalents in governmental banks	67,943	421,172	7,922	96,336	442,618	1,035,991
Investments	—	—	—	73,716	114,453	188,169
Receivables, net of allowance for uncollectibles:						
Taxes	1,193,211	16,750	—	—	—	1,209,961
Intergovernmental	300,104	—	—	—	—	300,104
Accounts	81,424	—	—	—	13,035	94,459
Loans	6,754	—	—	—	36	6,790
Accrued interest	10,114	1,676	—	162	469	12,421
Other	8,330	—	—	—	—	8,330
Due from:						
Other funds	433,039	—	—	—	156,142	589,181
Component units	83,209	—	—	—	42,186	125,395
Other governmental entities	—	—	—	—	13,866	13,866
Restricted assets:						
Cash and cash equivalents in commercial banks	692,621	—	—	—	16	692,637
Cash and cash equivalents in governmental banks	1,896,060	—	—	—	—	1,896,060
Other assets	33,605	—	—	—	—	33,605
Real estate held for future development	32,466	—	—	—	16,239	48,705
Total assets	<u>\$ 4,874,897</u>	<u>439,598</u>	<u>56,664</u>	<u>170,214</u>	<u>1,236,357</u>	<u>6,777,730</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Balance Sheet – Governmental Funds

June 30, 2006

(In thousands)

Liabilities and Fund Balances	General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
<b>Liabilities:</b>						
Accounts payable and accrued liabilities	\$ 1,916,682	10,236	88,690	4,102	63,788	2,083,498
Tax refunds payable	264,289	—	—	—	—	264,289
Due to:						
Other funds	232,325	—	—	—	373,385	605,710
Other governmental entities	19,103	—	—	—	—	19,103
Component units	244,570	—	—	—	13,681	258,251
Notes payable	495,446	—	—	—	30,598	526,044
Bonds payable	—	199,186	—	—	69,935	269,121
Interest payable	47,818	181,417	—	—	73,122	302,357
Deferred revenues	988,382	—	—	—	—	988,382
Tax revenue anticipation notes	1,050,037	—	—	—	—	1,050,037
<b>Total liabilities</b>	<b>5,258,652</b>	<b>390,839</b>	<b>88,690</b>	<b>4,102</b>	<b>624,509</b>	<b>6,366,792</b>
<b>Fund balances (deficit):</b>						
Reserved for:						
Encumbrances	611,419	—	—	—	24,587	636,006
Debt service	—	48,759	—	—	—	48,759
Assets in liquidation	71,621	—	—	—	—	71,621
Inventories	—	—	—	—	—	—
Long-term receivables	—	—	—	—	—	—
Low income housing assistance	87,588	—	—	—	—	87,588
Other specified purposes	—	—	—	—	—	—
Unreserved (deficit):						
General fund	(1,154,383)	—	—	—	—	(1,154,383)
Debt service funds	—	—	—	—	143,732	143,732
Special revenue funds	—	—	—	166,112	192,340	358,452
Capital projects funds	—	—	(32,026)	—	251,189	219,163
<b>Total fund balances (deficit)</b>	<b>(383,755)</b>	<b>48,759</b>	<b>(32,026)</b>	<b>166,112</b>	<b>611,848</b>	<b>410,938</b>
<b>Total liabilities and fund balances (deficit) \$</b>	<b>4,874,897</b>	<b>439,598</b>	<b>56,664</b>	<b>170,214</b>	<b>1,236,357</b>	<b>6,777,730</b>

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

**Reconciliation of the Balance Sheet to the Statement of Net Assets  
Governmental Funds**

**Year ended June 30, 2006**

**(In thousands)**

Amounts reported for governmental activities in the statement of net assets  
are different because:

Total fund balances of governmental funds	\$ 410,938
Inventories and prepaid expenses that are not available to pay for current period expenditures and therefore are not recognized in the funds	30,759
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	7,183,178
Long-term account receivable from Global tobacco settlement agreement and PBA	99,870
Deferred revenue in governmental funds that are recognized as revenue in the governmental activities	863,747
Debt issued by the Commonwealth have associated costs that are paid from current available resources in the funds. However, these costs are deferred on the statement of net assets	172,366
Net pension asset of the Puerto Rico Judiciary Retirement System recognized in governmental activities is not a financial resource and therefore is not reported in the funds	7,285
Liabilities, including Commonwealth accounts payable \$32,323, appropriation bonds (\$2,642,194), bonds payable (\$12,110,086), notes payable (\$3,293,734), capital leases payable (\$144,501), compensated absences (\$1,683,953), net pension obligation (\$4,740,806), and other long-term liabilities (\$1,161,776) are not due and payable in the current period and therefore are not reported in the funds	(25,744,727)
Interest liabilities are not due and payable in the current period and therefore are not reported in the funds	(232,979)
Deficit of governmental activities	<u>\$ (17,209,563)</u>

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**  
Statement of Revenue, Expenditures, and Changes in Fund Balances -  
Governmental Funds  
Year ended June 30, 2006  
(In thousands)

	General	Debt service	PBA capital projects	The Children's Trust special revenue	Other governmental	Totals governmental
<b>Revenue:</b>						
Taxes:						
Income taxes	\$ 6,181,995	—	—	—	—	6,181,995
Excise taxes	2,013,998	—	—	—	—	2,013,998
Other taxes	15,145	—	—	—	—	15,145
Charges for services	828,993	—	—	—	—	828,993
Revenue from global tobacco settlement agreement	—	—	—	—	65,602	65,602
Revenues from component units:						
Governing Board of 9-1-1 Services	8,828	—	—	—	—	8,828
Tourism Company of Puerto Rico	23,200	—	—	—	—	23,200
State Insurance Fund Corporation	36,717	—	—	—	—	36,717
Intergovernmental	4,522,786	118,326	—	—	22,310	4,663,422
Proceeds from sale of capital assets	15,943	—	—	—	—	15,943
Interest and investment earnings	97,929	2,046	—	4,590	12,515	117,080
Other	167,526	—	—	—	16,775	184,301
<b>Total revenue</b>	<b>13,913,060</b>	<b>120,372</b>	<b>—</b>	<b>4,590</b>	<b>117,202</b>	<b>14,155,224</b>
<b>Expenditures:</b>						
Current:						
General government	2,334,326	—	—	—	154,767	2,489,093
Public safety	2,107,355	—	—	—	797	2,108,152
Health	1,421,328	—	—	2,572	5,988	1,429,888
Public housing and welfare	3,119,011	—	—	—	11,362	3,130,373
Education	4,091,772	—	—	10,208	—	4,101,980
Economic development	465,875	—	—	1,959	48,610	516,444
Intergovernmental	408,039	—	—	—	1,688	409,727
Capital outlays	261,992	—	175,536	—	64,820	502,348
Debt service:						
Principal	168,360	199,186	—	—	78,735	446,281
Interest and other	274,827	364,579	—	383	181,073	820,862
Debt issuance costs	—	1,372	—	—	—	1,372
<b>Total expenditures</b>	<b>14,652,885</b>	<b>565,137</b>	<b>175,536</b>	<b>15,122</b>	<b>547,840</b>	<b>15,956,520</b>
<b>Excess of expenditures over revenue</b>	<b>(739,825)</b>	<b>(444,765)</b>	<b>(175,536)</b>	<b>(10,532)</b>	<b>(430,638)</b>	<b>(1,801,296)</b>
<b>Other financing sources (uses):</b>						
Transfers in	607,039	484,368	38,002	391	293,440	1,423,240
Transfers out	(1,046,651)	(100,000)	—	(26,688)	(7,259)	(1,180,598)
Long-term debt issued	1,295,239	101,695	—	—	121,421	1,518,355
Bond issue discount	—	(323)	—	—	—	(323)
Special item	—	—	—	54,135	—	54,135
Capital leases	4,580	—	—	—	—	4,580
<b>Total other financing sources</b>	<b>860,207</b>	<b>485,740</b>	<b>38,002</b>	<b>27,838</b>	<b>407,602</b>	<b>1,819,389</b>
<b>Net change in fund balances</b>	<b>120,382</b>	<b>40,975</b>	<b>(137,534)</b>	<b>17,306</b>	<b>(23,036)</b>	<b>18,093</b>
<b>Fund balances (deficit) at beginning of year (as restated)</b>	<b>(504,137)</b>	<b>7,784</b>	<b>105,508</b>	<b>148,806</b>	<b>634,884</b>	<b>392,845</b>
<b>Fund balances (deficit) at end of year</b>	<b>\$ (383,755)</b>	<b>48,759</b>	<b>(32,026)</b>	<b>166,112</b>	<b>611,848</b>	<b>410,938</b>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Reconciliation of the Statement of Revenue, Expenditures, and Changes in Fund Balances  
to the Statement of Activities – Governmental Funds

Year ended June 30, 2006

(In thousands)

Amounts reported for governmental activities in the statement of activities  
are different because:

Net change in fund balances – total governmental funds	\$ 18,093
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays (\$502,348) exceeded depreciation (\$222,794) in the current period.	279,554
Impairment of capital assets are expensed in the statement of activities, but not reported in the governmental funds as such impairment does not requires the use of current financial resources.	(62,895)
In the statement of activities, only the gain on the sale of capital assets are reported, whereas in the governmental funds, the proceeds from the sale increase financial resources. Therefore, the change in the net assets differs from the change in fund balance by the cost of the asset sold.	(20,643)
Revenue in the statement of activities that do not provide current financial resources are not reported as revenue in the governmental funds.	7,404
Debt proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount by which net proceeds (\$1,522,612) exceeded repayments (\$446,281).	(1,076,331)
Repayments of advances from a component unit provided current financial resources to governmental funds, but reduced the liability to component units in the statement of net assets.	13,050
Income tax revenue that are not currently available are deferred in the governmental funds, but are accruable as revenue in the statement of activities. This is the amount by which deferred revenue increased during the year.	3,396
Governmental funds do not report transfers of long-term assets or liabilities because such transfers do not represent financial resources; however, they are recorded in the statement of activities. This amount represents the transfer of property by the Commonwealth to certain municipalities (see note 12).	(78,958)
Generally, inventory and prepayments are recorded as expenditures in the governmental funds when purchased rather than capitalized as an asset. However, these assets are capitalized in the statement of net assets. This is the sum of the decrease in inventory (\$0) and net pension asset (\$2,826) for the year.	(2,826)
Debt issuance costs are expenditures to governmental funds, but are deferred assets in the statement of net assets. This is the amount of debt issue costs for the year.	1,372
Certain interest and other costs reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This is the amount equivalent to the increase in interest payable (\$7,060), combined with the amortization of debt issue costs (\$18,107), and the net accretion and amortization of debt issue discount and deferred losses (\$61,910).	(87,078)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental funds. This is the amount by which the net increases in net pension obligation (\$261,011), accrued compensated absences (\$214,607), and other liabilities (\$54,060) exceeded the net decreases in Christmas bonus liability (\$64,971), liability in federal cost disallowances (\$70,321), and liability for legal claims and judgments (\$125,819).	(214,507)
Effect of reversal of QZAB defeasance is reported as an expense in the statement of activities but not reported in the governmental funds.	(56,620)
Change in deficit of governmental activities	\$ (1,276,989)

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

**Statement of Revenue and Expenditures – Budget and Actual –  
Budget Basis – General Fund**

Year ended June 30, 2006

(In thousands)

	<b>Original budget</b>	<b>Amended budget</b>	<b>Actual</b>	<b>Variance</b>
<b>Revenue:</b>				
Income taxes	\$ 5,969,000	6,198,000	5,989,906	(208,094)
Excise taxes	2,210,000	2,084,000	1,966,986	(117,014)
Other taxes	112,000	106,000	101,882	(4,118)
Charge for services	231,000	253,000	228,663	(24,337)
Intergovernmental	26,000	20,000	9,553	(10,447)
Revenue from component units	20,000	20,000	23,167	3,167
Other	131,000	107,000	103,140	(3,860)
<b>Total revenue</b>	<b>8,699,000</b>	<b>8,788,000</b>	<b>8,423,297</b>	<b>(364,703)</b>
<b>Expenditures:</b>				
<b>Current:</b>				
General government	454,364	458,607	507,050	(48,443)
Public safety	1,927,738	2,036,528	2,109,969	(73,441)
Health	1,399,675	1,600,416	1,662,309	(61,893)
Public housing and welfare	458,402	458,052	481,600	(23,548)
Education	3,109,607	3,443,028	3,580,049	(137,021)
Economic development	475,204	481,930	492,779	(10,849)
Intergovernmental	384,321	384,376	416,949	(32,573)
<b>Debt service:</b>				
Principal	78,365	78,365	78,365	—
Interest and other	131,689	131,689	131,689	—
<b>Total expenditures</b>	<b>8,419,365</b>	<b>9,072,991</b>	<b>9,460,759</b>	<b>(387,768)</b>
<b>Excess (deficiency) of revenue over (under) expenditures</b>	<b>279,635</b>	<b>(284,991)</b>	<b>(1,037,462)</b>	<b>(752,471)</b>
<b>Other financing sources (uses):</b>				
Notes payable issued	100,000	1,064,726	1,344,897	280,171
Transfer in	146,000	157,000	167,941	10,941
Transfer out	(525,635)	(936,735)	(936,617)	118
<b>Total other financing sources (uses)</b>	<b>(279,635)</b>	<b>284,991</b>	<b>576,221</b>	<b>291,230</b>
<b>Excess (deficiency) of revenue and other sources over (under) expenditures and other uses</b>	<b>\$ —</b>	<b>—</b>	<b>(461,241)</b>	<b>(461,241)</b>

See accompanying notes to basic financial statements.



**COMMONWEALTH OF PUERTO RICO**

Statement of Net Assets – Proprietary Funds

June 30, 2006

(In thousands)

<b>Assets</b>	<b>Unemployment insurance</b>	<b>Lotteries</b>	<b>Other proprietary</b>	<b>Totals</b>
<b>Current assets:</b>				
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ —	49,434	37,757	87,191
Cash and cash equivalents in governmental banks	535,651	71,775	139,623	747,049
Receivables, net:				
Insurance premiums, net	56,766	—	8,034	64,800
Component units	—	—	7,605	7,605
Due from other funds	23,010	53,175	—	76,185
Accrued interest	566	—	2,287	2,853
Other	8,769	4,555	542	13,866
Investments:				
Restricted investments	—	—	33,473	33,473
<b>Total current assets</b>	<b>624,762</b>	<b>178,939</b>	<b>229,321</b>	<b>1,033,022</b>
<b>Noncurrent assets:</b>				
Loans receivable, excluding current portion, net:				
Component units	—	—	180,450	180,450
Intergovernmental	—	—	1,819	1,819
Capital assets, net	—	1,008	—	1,008
Other	—	40,251	—	40,251
<b>Total assets</b>	<b>\$ 624,762</b>	<b>220,198</b>	<b>411,590</b>	<b>1,256,550</b>
<b>Liabilities and Net Assets (Deficit)</b>				
<b>Current liabilities:</b>				
Accounts payable and accrued liabilities	\$ —	3,585	2,984	6,569
Due to other funds	—	59,654	—	59,654
Deferred revenue	11,745	19,015	26	30,786
Compensated absences	—	2,338	1,519	3,857
Lottery awards	—	37,488	—	37,488
Insurance benefits payable	69,833	—	1,140	70,973
<b>Total current liabilities</b>	<b>81,578</b>	<b>122,080</b>	<b>5,669</b>	<b>209,327</b>
<b>Noncurrent liabilities:</b>				
Compensated absences	—	1,910	1,598	3,508
Lottery awards	—	266,215	—	266,215
<b>Total liabilities</b>	<b>\$ 81,578</b>	<b>390,205</b>	<b>7,267</b>	<b>479,050</b>
<b>Net assets:</b>				
Invested in capital assets	\$ —	1,008	—	1,008
Restricted for:				
Payment of insurance benefits	543,184	—	156,582	699,766
Capital projects	—	—	247,741	247,741
Unrestricted	—	(171,015)	—	(171,015)
<b>Total net assets (deficit)</b>	<b>\$ 543,184</b>	<b>(170,007)</b>	<b>404,323</b>	<b>777,500</b>

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

**Statement of Revenue, Expenses, and Changes in Net Assets -  
Proprietary Funds**

Year ended June 30, 2006

(In thousands)

	<b>Unemployment insurance</b>	<b>Lotteries</b>	<b>Other proprietary</b>	<b>Totals</b>
Operating revenues:				
Lottery ticket sales	\$ —	868,295	—	868,295
Insurance premiums	251,254	—	24,099	275,353
Interest	—	—	5,726	5,726
Other	—	52	—	52
Total operating revenues	251,254	868,347	29,825	1,149,426
Operating expenses:				
Lottery awards	—	532,793	—	532,793
Insurance benefits	207,483	—	4,277	211,760
General, administrative, and other operating expenses	—	137,244	20,766	158,010
Depreciation and amortization	—	388	—	388
Total operating expenses	207,483	670,425	25,043	902,951
Operating income	43,771	197,922	4,782	246,475
Nonoperating revenue:				
Contributions from federal government	35,418	—	24,195	59,613
Interest and investment earnings	25,892	6,380	893	33,165
Total nonoperating revenue	61,310	6,380	25,088	92,778
Income before transfers	105,081	204,302	29,870	339,253
Transfers from general fund	204,330	21,318	4,802	230,450
Transfers to general fund	(268,790)	(204,302)	—	(473,092)
Net change in net assets	40,621	21,318	34,672	96,611
Net assets (deficit) at beginning of year as restated	502,563	(191,325)	369,651	680,889
Net assets (deficit) at end of year	\$ 543,184	(170,007)	404,323	777,500

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Statement of Cash Flows  
Proprietary Funds

Year ended June 30, 2006

(In thousands)

	Unemployment insurance	Lotteries	Other proprietary	Totals
Cash flows from operating activities:				
Receipts from customers and users	\$ 250,923	865,952	21,025	1,137,900
Other receipts	—	52	15,248	15,300
Payments to suppliers and employees	3,242	(146,000)	(20,601)	(163,359)
Payment of lottery prizes	—	(558,199)	—	(558,199)
Payments of insurance benefits	(207,483)	—	(4,332)	(211,815)
Other payments	—	—	(43,759)	(43,759)
Net cash provided by (used in) operating activities	46,682	161,805	(32,419)	176,068
Cash flows from noncapital financing activities:				
Intergovernmental grants and contributions	35,418	—	24,107	59,525
Principal payments of notes payable	—	(520)	—	(520)
Transfers from other funds	175,531	—	4,802	180,333
Transfers to other funds	(268,790)	(159,791)	—	(428,581)
Net cash provided by (used in) noncapital financing activities	(57,841)	(160,311)	28,909	(189,243)
Cash flows from capital and related financing activities:				
Capital expenditures	—	(29)	—	(29)
Net cash used in capital and related financing activities	—	(29)	—	(29)
Cash flows from investing activities:				
Interest received on deposits and investments	25,905	6,380	1,391	33,676
Net cash provided by investing activities	25,905	6,380	1,391	33,676
Net increase (decrease) in cash and cash equivalents	14,746	7,845	(2,119)	20,472
Cash and equivalents at beginning of year	520,905	113,364	179,499	813,768
Cash and cash equivalents at end of year	\$ 535,651	121,209	177,380	834,240
Reconciliation of operating income to net cash provided by (used in) operating activities:				
Operating income	\$ 43,771	197,922	4,782	246,475
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Depreciation and amortization	—	388	—	388
Interests earned on deposits loans and investments	—	—	(371)	(371)
Changes in operating assets and liabilities:				
Increase in accounts and loans receivable	(331)	(2,343)	(35,564)	(38,238)
Decrease in obligation for unpaid lottery awards	—	(25,405)	—	(25,405)
Decrease in due to other funds	—	(9,514)	—	(9,514)
Increase (decrease) in deferred revenues	3,242	1,911	(3)	5,150
Increase (decrease) in compensated absences	—	(589)	1,451	862
Decrease in liability for insurance benefits payable	—	—	(407)	(407)
Decrease in accounts payable and accrued liabilities	—	(243)	(2,307)	(2,550)
Decrease in other assets	—	(322)	—	(322)
Total adjustments	2,911	(36,117)	(37,201)	(70,407)
Net cash provided by (used in) operating activities	\$ 46,682	161,805	(32,419)	176,068

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

Statement of Fiduciary Net Assets

June 30, 2006

(In thousands)

<b>Assets</b>	<b>Pension trust</b>	<b>Special deposits – agency</b>
Cash and cash equivalents in commercial banks and U.S. Treasury:		
Unrestricted	\$ 82,963	583,196
Restricted	1,717	—
Cash and cash equivalents in governmental banks:		
Unrestricted	28,951	46,984
Restricted	2,156	—
Investments:		
Debt and equity securities, at fair value	3,957,755	27,013
Investment in PRTA Holdings, at appraised value	495,318	—
Other	87,824	—
Receivables, net:		
Accounts	44,622	—
Loans and advances	881,159	—
Accrued interest and dividends	32,726	—
Due from general fund	10,401	—
Other	51,280	—
Capital assets, net	33,359	—
Other assets	8,283	—
Total assets	<u>5,718,514</u>	<u>657,193</u>
<b>Liabilities</b>		
Accounts payable and accrued liabilities	77,938	657,193
Repurchase agreements	139,074	—
Due to component unit	4	—
Other liabilities	60,000	—
Bonds payable	20,430	—
Total liabilities	<u>297,446</u>	<u>657,193</u>
<b>Net Assets</b>		
Net assets held in trust for pension and other benefits	\$ <u>5,421,068</u>	<u>—</u>

See accompanying notes to basic financial statements.

**COMMONWEALTH OF PUERTO RICO**

**Statement of Changes in Fiduciary Net Assets – Pension Trust Funds**

Year ended June 30, 2006

(In thousands)

Additions:

Contributions:

Sponsor	\$ 524,298
Participants	475,130
Special	77,750
Total contributions	<u>1,077,178</u>

Interest and investment income:

Interest	122,605
Dividends	64,827
Net change in fair value of investments	453,515
Investment expenses	<u>(16,194)</u>
Net interest and investment income	<u>624,753</u>

Other income

Total additions	<u>1,738,286</u>
-----------------	------------------

Deductions:

Pension and other benefits	1,191,980
Refunds of contributions	26,508
General and administrative	<u>57,537</u>
Total deductions	<u>1,276,025</u>

Net change in net assets held in trust for pension and other benefits	462,261
---	---------

Net assets held in trust for pension and other benefits:

Beginning of year	<u>4,958,807</u>
End of year	<u>\$ 5,421,068</u>

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Net Assets --  
Major Component Units

June 30, 2006

(In thousands)

Assets	Government Development Bank for Puerto Rico	Puerto Rico Highway and Transportation Authority	Puerto Rico Electric Power Authority	Puerto Rico Aqueduct and Sewer Authority	Puerto Rico Infrastructure Financing Authority	Puerto Rico Health Insurance Administration	University of Puerto Rico	Total nonmajor component units	Total component units
Assets:									
Current assets:									
Cash and cash equivalents	\$ 2,479,515	73,093	18,614	7,764	—	44,095	45,916	119,855	2,788,852
Cash and cash equivalents in governmental banks	—	—	—	65,374	49,892	34,676	46,923	438,785	635,650
Investments, including collateral from securities lending transactions	821,945	—	—	—	—	—	—	1,652,532	2,474,477
Receivables, net:									
Insurance premiums	—	—	—	—	—	—	—	109,780	109,780
Intergovernmental	—	—	—	10,661	—	—	28,415	1,925	41,001
Accounts	—	3,791	549,048	44,111	—	—	14,182	176,283	787,415
Loans and advances	4,955,136	—	—	—	—	—	—	53,876	5,009,012
Accrued interest	292,392	—	3,449	—	934	136	—	35,332	332,243
Other governmental entities	—	—	88,656	40,756	5,436	7,150	17,099	41,992	201,089
Other	—	—	—	3,594	34,226	3,629	1,821	73,022	116,292
Due from:									
Primary government	—	—	133,608	—	—	23,857	50,134	72,549	280,148
Component units	2,313,577	—	25,844	—	—	—	18,030	21,141	2,378,592
Inventories	—	—	277,802	13,745	—	—	7,115	39,465	338,127
Prepays	—	5,294	5,406	1,905	591	18	32,284	10,603	56,101
Total current assets	10,862,565	82,178	1,102,427	187,910	91,079	113,561	261,919	2,847,140	15,548,779
Noncurrent assets:									
Restricted assets:									
Cash and cash equivalents	52,675	4,099	337,744	150	90,958	—	15,766	326,976	828,368
Cash and cash equivalents in governmental banks	—	30,438	—	32,596	17,988	—	—	716,022	797,044
Investments	1,673,479	820,143	374,676	—	1,555,704	—	148,462	2,214,695	6,787,159
Receivables:									
Loans, interest, and other	—	—	—	—	—	—	2,469	121,214	123,683
Interest-bearing deposits with other	—	—	—	—	—	—	—	6,659	6,659
Other governmental entities	—	—	—	—	—	—	—	32,663	32,663
Other	—	—	—	—	—	—	—	531	531
Due from:									
Primary government	—	—	36,754	—	—	—	56,000	—	92,754
Component units	—	—	—	—	—	—	—	17,303	17,303
Property held for sale and future development	70,898	—	—	—	—	—	—	141,199	212,097
Capital assets, not being depreciated	13,546	3,203,805	2,103,257	845,345	1,052,993	—	266,407	1,288,859	8,774,212
Capital assets, depreciable, net	14,313	7,953,943	3,334,404	4,081,278	85	828	491,170	1,960,702	17,836,723
Deferred expenses and other assets	59,336	133,180	128,849	28,738	58,829	—	—	44,498	453,430
Total noncurrent assets	1,884,247	12,145,608	6,315,684	4,988,107	2,776,557	828	980,274	8,341,419	37,432,724
Total assets	\$ 12,746,812	12,227,786	7,418,111	5,176,017	2,867,636	114,389	1,242,193	11,188,559	52,981,503

COMMONWEALTH OF PUERTO RICO

Combining Statement of Net Assets --  
Major Component Units

June 30, 2006

(In thousands)

Liabilities and Net Assets	Government Development Bank for Puerto Rico	Puerto Rico Highway and Transportation Authority	Puerto Rico Electric Power Authority	Puerto Rico Aqueduct and Sewer Authority	Puerto Rico Infrastructure Financing Authority	Puerto Rico Health Insurance Administration	University of Puerto Rico	Total nonmajor component units	Total component units
<b>Liabilities:</b>									
Current liabilities:									
Accounts payable and accrued liabilities	\$ 111,017	144,452	570,097	368,600	77,140	84,648	112,978	847,037	2,315,969
Deposits and escrow liabilities	5,838,162	—	155,366	5,271	—	—	—	647,157	6,645,956
Due to:									
Primary government	—	—	—	8,115	—	25,800	—	92,487	126,402
Component units	—	29,996	113,467	39,449	925	—	86,781	385,518	656,136
Other governmental entities	—	—	—	—	—	—	125	37,485	37,610
Securities lending transactions and reverse repurchase agreements	515,000	—	—	—	—	—	—	277,844	792,844
Interest payable	51,144	163,073	136,696	11,263	67,842	—	4,765	107,468	542,251
Deferred revenue	—	—	—	—	2,199	—	25,598	98,758	126,555
Notes payable, current portion	1,048,867	—	379,835	—	—	—	—	129,234	1,557,936
Commonwealth appropriation bonds, current portion	45	—	—	2,733	46	—	—	1,207	4,031
Bonds payable, current portion	94,111	98,520	377,532	26,641	30,695	—	20,625	129,213	777,337
Accrued compensated absences	3,547	15,739	75,428	16,962	129	442	22,506	97,948	232,701
Worker's compensation claims	—	—	—	—	—	—	—	696,922	696,922
Reserves for automobile accident benefit payments	—	—	—	—	—	—	—	114,388	114,388
Current portion of other long-term liabilities	—	4,149	90,002	—	—	—	1,779	56,324	152,254
Total current liabilities	7,661,893	455,929	1,898,423	479,034	178,976	110,890	275,157	3,718,990	14,779,292
Noncurrent liabilities:									
Due to:									
Primary government	—	—	—	179,940	—	—	—	7,108	187,048
Component units	—	—	59,200	685,701	44,089	—	9,864	932,831	1,731,685
Interest payable	4,499	—	—	—	—	—	—	—	4,499
Deferred revenue	—	—	—	—	—	—	—	23,385	23,385
Notes payable	1,686,090	—	32,000	—	—	—	—	1,046,347	2,764,437
Commonwealth appropriation bonds	10,199	—	—	704,035	10,507	—	—	296,356	1,021,097
Bonds payable	1,285,986	6,542,692	4,778,998	802,717	2,551,562	—	445,561	2,326,116	18,733,632
Accrued compensated absences	1,709	12,380	138,306	35,342	143	294	112,569	24,040	324,783
Other long-term liabilities	—	31,940	—	65,432	5,998	—	68,827	154,824	327,021
Total noncurrent liabilities	2,988,483	6,587,012	5,008,504	2,473,167	2,612,299	294	636,821	4,811,007	25,117,587
Total liabilities	10,650,376	7,042,941	6,906,927	2,952,201	2,791,275	111,184	911,978	8,529,997	39,896,879
<b>Net assets:</b>									
Invested in capital assets, net of related debt	27,859	4,478,815	269,241	3,201,573	1,053,079	828	207,168	1,576,736	10,815,299
Restricted for:									
Trust – nonexpendable	—	—	—	—	1,335,171	—	52,248	—	1,387,419
Capital projects	—	72,417	206,748	32,746	225,353	—	35,235	80,616	653,115
Debt service	55,682	605,864	—	—	307	—	37,558	209,597	909,008
Affordable housing and related loan insurance programs	254,219	—	—	—	—	—	—	526,912	781,131
Student loans and other educational purposes	—	—	—	—	—	—	7,867	9,454	17,321
Other specified purposes	—	—	—	—	17,989	—	32,520	100,281	150,790
Unrestricted	1,758,676	27,749	35,195	(1,010,503)	(2,555,538)	2,377	(42,381)	154,966	(1,629,459)
Total net assets	2,096,436	5,184,845	511,184	2,223,816	76,361	3,205	330,215	2,658,562	13,084,624
Total liabilities and net assets	\$ 12,746,812	12,227,786	7,418,111	5,176,017	2,867,636	114,389	1,242,193	11,188,559	52,981,503

See accompanying notes to basic financial statements.

COMMONWEALTH OF PUERTO RICO

Combining Statement of Activities –  
Major Component Units

Year ended June 30, 2006

(In thousands)

		Program revenues			Net revenues		Payments		Contributions		Interest and	Gain		Net assets,	
	Expenses	Charges for	Operating	Capital	(expenses)	Payments	from (to)	not restricted	Taxes	investment	in sale of	Miscellaneous	Change in	beginning of	Net assets,
		services	grants and	grants and	and changes	from primary	other	to specific		earnings	assets		net assets	year, as	end of year
			contributions	contributions	in net assets	government	component	programs						restated	
Major component units:															
Government Development Bank															
for Puerto Rico	\$ 688,830	593,004	—	156,365	60,539	65,316	(252)	—	—	—	—	8,670	134,273	1,962,163	2,096,436
Puerto Rico Highway and															
Transportation Authority	904,973	245,109	—	83,768	(576,096)	—	—	—	296,814	31,438	—	—	(247,844)	5,432,689	5,184,845
Puerto Rico Electric															
Power Authority	3,780,539	3,716,082	—	—	(64,457)	—	—	56,378	—	24,475	—	—	16,396	494,788	511,184
Puerto Rico Aqueduct and															
Sewer Authority	841,300	469,939	8,789	—	(362,572)	19,096	53,396	12,380	—	3,180	—	5,670	(268,850)	2,492,666	2,223,816
Puerto Rico Infrastructure															
Finance Authority	126,469	—	—	—	(126,469)	72,450	(53,396)	—	—	(175,665)	—	—	(283,080)	359,441	76,361
Puerto Rico Health Insurance															
Administration	1,561,451	452,965	—	—	(1,108,486)	1,134,152	—	—	—	2,232	—	—	27,898	(24,693)	3,205
University of Puerto Rico	1,237,194	166,023	238,149	—	(833,022)	812,594	69,035	5,439	—	5,802	—	14,237	74,085	256,130	330,215
Nonmajor component units	2,485,772	1,829,229	37,742	24,254	(594,547)	323,553	(68,783)	3,715	66,277	188,311	8,737	(8,231)	(80,968)	2,739,530	2,658,562
Total component units	\$ 11,626,528	7,472,351	284,680	264,387	(3,605,110)	2,427,161	—	77,912	363,091	79,773	8,737	20,346	(628,090)	13,712,714	13,084,624

See accompanying notes to basic financial statements.



## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

#### (1) Summary of Significant Accounting Policies

The Commonwealth of Puerto Rico (the Commonwealth) was constituted on July 25, 1952, under the provisions of its Constitution as approved by the people of Puerto Rico and the U.S. Congress. The Commonwealth's Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government. The Commonwealth assumes responsibility for public safety, health, public housing and welfare, education, and economic development.

The accompanying basic financial statements of the Commonwealth have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The accompanying basic financial statements present the financial position of the Commonwealth and its various funds, the results of operations of the Commonwealth and its various funds and fund types, and the cash flows of the proprietary funds. The basic financial statements are presented as of June 30, 2006, and for the year then ended. The basic financial statements include the various departments, agencies, boards, commissions, public trusts and public corporations, and any other organizational units governed by the Puerto Rico Legislature and/or officers of the Commonwealth.

##### (a) *The Financial Reporting Entity*

The accompanying basic financial statements include all departments, agencies, and governmental entities whose funds are under the custody and control of the Secretary of the Treasury of the Commonwealth and the Commonwealth's component units pursuant to Act No. 230 of July 23, 1974, as amended, known as Commonwealth of Puerto Rico Accounting Law. The Commonwealth has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Commonwealth to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Commonwealth.

As required by U.S. GAAP, these basic financial statements present the Commonwealth and its component units.

##### (b) *Component Units*

Component units are entities that are legally separate organizations for which the Commonwealth's elected officials are financially accountable or other organizations for which the nature and significance of their relationship with the Commonwealth are such that exclusion would cause the Commonwealth's basic financial statements to be misleading and incomplete. GAAP details two methods of presentation: blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Commonwealth's balances and transactions; or discrete presentation of the component units' financial data in columns separate from the Commonwealth's balances and transactions. The Commonwealth is financially accountable

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

because it appoints the members of the governing authorities of each of the component units and because it is able to impose its will on these organizations or because the organizations provide financial benefits or impose financial burdens on the Commonwealth. The financial statements of the component units discussed below have been included in the financial reporting entity either as blended component units or as discretely presented component units in accordance with GASB Statement No. 14, *The Financial Reporting Entity*, as amended by GASB 39 *Determining Whether Certain Organization are Component Units*.

#### **Blended Component Units**

The following entities, while legally separate from the Commonwealth, meet the criteria to be reported as part of the primary government because they provide services entirely or almost entirely to the Commonwealth.

***Public Buildings Authority (PBA)*** – PBA is governed by a six-member board comprised by the Secretary of the Department of Transportation and the Public Works (DTPW), the Secretary of the Department of Education of the Commonwealth, the Interim President of the Government Development Bank for Puerto Rico (GDB), and three members appointed by the Governor of Puerto Rico with the advice and consent of the Senate. It is a legally separate entity, whose activities are blended within the primary government because it exists to construct, purchase, or lease office, school, health, correctional, social welfare, and other facilities for lease to the Commonwealth's departments, component units, and instrumentalities. Bonds issued by PBA to finance such facilities are payable from lease collections, which are largely derived from Commonwealth appropriations and are further secured by the Commonwealth's guaranty.

***Puerto Rico Maritime Shipping Authority (PRMSA)*** – PRMSA is governed by the President of GDB. The operations of PRMSA consist of servicing the long-term liability to third parties that resulted from the sale of certain maritime operations formerly owned and operated by PRMSA. The Commonwealth is required to annually appropriate funds in its general operating budget to provide for the payment of principal and interest on such debt [see note 14 (d)].

***The Children's Trust (the Trust)*** – The Trust is governed by a seven-member board comprised by the Governor, who designated the president of the board, the President of GDB, the Director of the Office of Management and Budget (OMB) of the Commonwealth, the Secretary of Justice of the Commonwealth, and three private citizens appointed by the Governor with the consent of the Senate. The Trust's sole operation consists of providing financial assistance principally to the Commonwealth's departments to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico, especially in the areas of education, recreation, and health. The operation of the Trust is financed with the moneys being received by the Commonwealth from a global settlement agreement dated November 23, 1998, between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies shall continue making contributions in perpetuity.

The blended component units are composed of various funds. The PBA capital projects and the Children's Trust special revenue fund are presented as major governmental funds. All other funds are

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

reported in the other governmental column. Complete financial statements of the blended component units can be obtained directly by contacting their respective administrative offices at:

Public Buildings Authority  
P.O. Box 41029 Minillas Station  
San Juan, PR 00940-1029

Puerto Rico Maritime  
Shipping Authority  
P.O. Box 42001  
San Juan, PR 00940-2001

The Children's Trust  
P.O. Box 42001  
San Juan, PR 00940-2001

#### **Discretely Presented Component Units**

The following component units, consistent with GASB No. 14, are discretely presented in the basic financial statements because of the nature of the services they provide, the Commonwealth's ability to impose its will, principally through the appointment of their governing authorities, and because the component units provide specific financial benefits to, or impose financial burdens on, the Commonwealth. These have been classified by management between major and nonmajor component units.

#### **Major Component Units**

***Government Development Bank for Puerto Rico (GDB)*** – is governed by a seven-member board appointed by the Governor. GDB acts as fiscal agent, depository of funds, disbursing agent, and financial advisor for the Commonwealth, its public corporations, and municipalities in connection with the issuance of bonds and notes; and it also makes loans and advances funds predominantly to the Commonwealth's departments, component units, and municipalities. GDB's board of directors members are executives on a trustworthy position, named and supervised by the Governor. The Commonwealth provides financial support to GDB through legislative appropriations.

***Puerto Rico Aqueduct and Sewer Authority (PRASA)*** – PRASA is governed by a nine-member board comprised of five members appointed by the Governor, the Secretary of DTPW, the President of GDB, and two members elected in a referendum carried out by the Puerto Rico Consumer Affairs Department. PRASA owns and operates the system of public water supply and sanitary sewer facilities. PRASA is authorized, among other things, to borrow money and issue revenue bonds for any of its corporate purposes. Through the approval of Act No. 328 of 1998, as discussed in note 15 (a), the Commonwealth guarantees the principal and interest payments of certain outstanding bonds and of all future bonds issued to refinance those outstanding bonds, and other loans under the State Revolving Fund Program. The Commonwealth provides financial support to PRASA through legislative appropriations.

***Puerto Rico Electric Power Authority (PREPA)*** – PREPA is governed by a nine-member board comprised of the Secretary of DTPW, six members appointed by the Governor with the consent of the Senate, and two members representing the consumers' interest elected in a referendum carried out by the Puerto Rico Consumer Affairs Department. Board members are appointed or elected for a period of four years. PREPA is responsible for conserving, developing, and utilizing the power

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

resources of Puerto Rico and owns and operates the Commonwealth's electrical power generation, transmission, and distribution system. The Commonwealth provides financial support to PREPA through legislative appropriation.

***Puerto Rico Health Insurance Administration (PRHIA)*** – PRHIA is governed by a nine-member board comprised by the Secretary of Health of the Commonwealth, the Secretary of the Treasury of the Commonwealth, and the Insurance Commissioner of Puerto Rico, being these members inherent by law, and six additional members appointed by the Governor, with the consent of the Senate. PRHIA was created for implementing, administering, and negotiating a health insurance system through contracts with insurance underwriters to provide quality medical and hospital care to low income individuals, employees of the Commonwealth, and policeman who voluntarily subscribe to the Puerto Rico health insurance medical plan. The board of directors' president is elected by the Governor and all board of directors' members are executives on a trustworthy position. The Commonwealth provides financial support to PRHIA through legislative appropriations.

***Puerto Rico Highways and Transportation Authority (PRHTA)*** – PRHTA is governed by the Secretary of DTPW. PRHTA has broad powers to carry out its responsibilities in accordance with DTPW's overall transportation policies. These powers include, among other things, the complete control and supervision of any highway facilities constructed, owned, or operated by PRHTA, the ability to set tolls for the use of the highway facilities, and the power to issue bonds, notes, or other obligations. PRHTA plans and manages the construction of all major projects relating to the Commonwealth toll highway system, undertakes major repairs, and maintains the toll ways. The Commonwealth has the ability to significantly influence rates charged by PRHTA.

***Puerto Rico Infrastructure Financing Authority (PRIFA)*** – PRIFA is governed by the board of directors of GDB and the Secretary of the Treasury of the Commonwealth. Its responsibilities are to provide financial, administrative, consulting, technical, advisory, and other types of assistance to other component units and governmental instrumentalities of the Commonwealth, which are authorized to develop infrastructure facilities and to establish alternate means for financing them. PRIFA's board of directors' members are executives on a trustworthy position, named and supervised by the Governor. The Commonwealth provides financial support to PRIFA through legislative appropriations.

***University of Puerto Rico (UPR)*** – UPR is governed by a thirteen-member board of trustees comprised of one full-time student, two permanent professors, and ten community citizens of the private sector, of which at least one must be graduated from the institution. Community citizens are designated by the Governor with the advice and consent of the Senate. Members designated by the Governor are appointed for a period of four to eight years. The terms for the student and professors are one year. The Commonwealth provides financial support to UPR through legislative appropriations.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

#### Nonmajor Component Units

***Agricultural Services and Development Administration (ASDA)*** – ASDA is governed by the Secretary of Agriculture of the Commonwealth. The purpose of ASDA is to provide a wide variety of services and incentives to the agricultural sector. Therefore, the government has the ability to impose its will. The Commonwealth provides financial support to ASDA through legislative appropriations.

***Automobile Accidents Compensations Administration (AACA)*** – AACA is governed by a four-member board appointed by the Governor with the advice and consent of the Senate. AACA operates a system of compulsory insurance coverage for all registered motor vehicles and compensates citizens for injuries arising from motor vehicle accidents. The Commonwealth has the ability to significantly influence rates charged by AACA.

***Cardiovascular Center Corporation of Puerto Rico and the Caribbean (CCCPRC)*** – CCCPRC is governed by a five-member board comprised of the Secretary of Health of the Commonwealth, the Director of the Medical Sciences Campus of the UPR, the Executive Director of the Puerto Rico Medical Services Administration, and two additional members appointed by the Governor with the consent of the Senate, one of which should be from the Cardiology Society of Puerto Rico and another a member of a cardiology foundation properly registered in the Department of State of the Commonwealth. The purpose of the CCCPRC is to provide special treatment to patients suffering from cardiovascular diseases. The Commonwealth provides financial support to CCCPRC through legislative appropriations.

***Caribbean Basin Projects Financing Authority (CBPFA)*** – CBPFA is governed by a seven-member board comprised of the Secretary of State of the Commonwealth, the Executive Director of the Puerto Rico Industrial Development Company (PRIDCO), the President of GDB, the President of the Economic Development Bank for Puerto Rico, and three citizens, including at least two from the private sector, appointed by the Governor with the advice and consent of the Senate. CBPFA is authorized to issue revenue bonds and to lend the proceeds thereof to finance projects for the development of the Caribbean Basin countries that were authorized to receive investments of funds under the provisions of Section 936 of the U.S. Internal Revenue Code. The Commonwealth has access to CBPFA's resources.

***Culebra Conservation and Development Authority (CCDA)*** – CCDA is a component unit of the Commonwealth of Puerto Rico created by Law No. 66 of June 22, 1975, as amended, to formulate, adopt, and administer the program and plan for the conservation, use, and development of natural resources of the Municipality of Culebra. CCDA is administered through a board of directors composed of seven members, including the Mayor of Culebra. The administration and operations of the Authority are conducted by an Executive Director elected by the board of directors. Law No. 66 of June 22, 1975 was amended by Law No. 76 of June 6, 2002 to ascribe CCDA to the Municipality of Culebra.



## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

***Economic Development Bank for Puerto Rico (EDB)*** – EDB is governed by a eleven-member board comprised of the President of GDB, who is the Chairman, the Secretary of Agriculture of the Commonwealth, the Secretary of the Department of Economic Development and Commerce of the Commonwealth, the Executive Director of the Puerto Rico Industrial Development Company, the Executive Director of the Tourism Company of Puerto Rico, and six other members representing the private sector and appointed by the Governor with the consent of the Senate. Private sector members are appointed for a period of three years. EDB is responsible for the promotion and development of the private sector economy of the Commonwealth. This purpose is to be met by granting direct loans, loan guarantees, and/or direct investments to any person or business organization devoted to manufacturing, agriculture, trade, tourism, or other service enterprises with preference to but not limited to economic activities that may have the effect of substituting imports. The Commonwealth has the ability to impose its will on this component unit.

***Employment and Training Enterprises Corporation (ETEC)*** – ETEC is governed by a consultant board, which includes two private citizens appointed by the Governor with the consent of the Senate. The purpose of ETEC is to provide training, management, development, and employment for inmates of the correctional institutions of the Commonwealth. The Commonwealth provides financial support to ETEC through legislative appropriations.

***Farm Insurance Corporation of Puerto Rico (FICPR)*** – FICPR is governed by a four-member board consisting of the Secretary of Agriculture of the Commonwealth, the Dean of the Agricultural Sciences Faculty of the UPR Mayaguez Campus, a representative of GDB, and one bona fide farmer appointed by the Governor with the consent of the Senate. The purpose of the FICPR is to provide insurance to farmers against losses on their farms caused by natural disasters.

***Fine Arts Center Corporation (FACC)*** – FACC is governed by a nine-member board comprised of the President of the Musical Arts Corporation and eight members named by the Governor. FACC was created with the purpose of administering the Fine Arts Center. The Commonwealth provides financial support to FACC through legislative appropriations.

***Governing Board of the 9-1-1 Service (911 Service)*** – The Governing Board of 911 Service (the Board) is governed by a five-member board comprised of the Chief of Police, the Executive Director of the Medical Emergency Services, the Director of the State Emergency Management Agency, the Chief of the Puerto Rico Firefighters Corps, and one member appointed by consensus of the four ex-officio members to represent the public interest. The 911 Service is responsible for providing an efficient service of fast response to emergency calls through the 911 number and transferring these to the appropriate response agencies using technological and human resources to safeguard lives and properties. The Commonwealth has access to 911 Service's resources.

***Institutional Trust of the National Guard of Puerto Rico (ITNGPR)*** – ITNGPR is governed by a six-member board comprised of the National Guard Special Assistant, the President of GDB, the Secretary of Justice of the Commonwealth, two militaries from the Puerto Rico National Guard, and one representative from the community recommended by the National Guard Special Assistant and appointed by the Governor. ITNGPR's purpose is to provide life insurance, retirement benefits, and economic assistance to the active members of the Puerto Rico National Guard and their families. The Commonwealth provides financial support to ITNGPR through legislative appropriations.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

***Land Authority of Puerto Rico (LAPR)*** – LAPR is governed by a six-member board consisting of the Secretary of Agriculture of the Commonwealth and five members appointed by the Governor. LAPR was created to carry out the provisions of the Land Law of Puerto Rico. LAPR maintains debt that is paid with Commonwealth appropriations.

***Musical Arts Corporation (MAC)*** – MAC is governed by a seven-member board appointed by the Governor with the consent of the Senate. MAC was created to promote the development of the arts and cultural programs of the Commonwealth. The Commonwealth provides financial support to MAC through legislative appropriations.

***National Parks Company of Puerto Rico (NPCPR)*** – NPCPR is governed by a nine-member board comprised of the Secretary of Recreation and Sports of the Commonwealth (the Secretary), who is the chairman, the Secretary of Education of the Commonwealth, the Executive Director of the Puerto Rico Tourism Company (PRTC), the Secretary of Natural and Environmental Resources of the Commonwealth, and five members appointed by the Governor with the recommendation from the Secretary and with known interest in the development and preservation of parks in the private sector. NPCPR is responsible for the operation of all national parks and the protection, conservation, and use of parks, beaches, forests, and natural and historical monuments for the optimum enjoyment of present and future generations. The Commonwealth provides financial support to NPCPR through legislative appropriations.

***Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives (PCSDIPRC)*** – PCSDIPRC is governed by a nine-member board consisting of the Administrator of the Cooperative Development Administration, the Commissioner of Financial Institutions of Puerto Rico (the Commissioner of Financial Institutions), the Commissioner of Insurance of Puerto Rico, the Secretary of the Treasury of the Commonwealth, the Inspector of Cooperatives, four citizens representing the cooperative movement, and one private citizen representing the public interest. PCSDIPRC has the responsibility of providing to all the cooperatives and the Federation of Cooperatives of Puerto Rico insurance coverage over the stocks and deposits, for monitoring the financial condition of the insured cooperatives, and of uninsured cooperatives when requested by the Commissioner of Financial Institutions.

***Puerto Rico Conservatory of Music Corporation (PRCMC)*** – PRCMC is governed by a six-member board appointed by the Governor, with the consent of the Senate. PRCMC is responsible for providing the Puerto Rican community and especially its youths with the required facilities to educate and perfect their musical skills, including secondary education programs for developing musical arts. It prepares the artistic element that nourishes the Puerto Rico Symphony Orchestra and other musical organizations, and coordinates the governmental efforts to interested industries, private enterprises, and particular citizens. The Commonwealth provides financial support to PRCMC through legislative appropriations.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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***Puerto Rico Convention Center District Authority (PRCCDA)*** – PRCCDA is governed by a board comprised of nine members, four of which shall be from the public sector and five from the private sector. The public sector members are comprised of the Secretary of Economic Development and Commerce of the Commonwealth, who is the Chairman, the Executive Director of the Puerto Rico Tourism Company, the president of GDB, and one member from the public sector. The private sector members are individuals having experience in the areas of hospitality, tourism, real estate, or convention centers who are appointed by the Governor with the advice and consent of the Senate. PRCCDA was created to develop, own, finance, plan, design, construct, operate, manage, and promote the new Puerto Rico Convention Center. The Commonwealth provides financial support to PRCCDA through legislative appropriations.

***Puerto Rico Council on Higher Education (PRCHE)*** – PRCHE is governed by a board comprised of eight members appointed by the Governor with the consent of the Senate and the Secretary of Education of the Commonwealth as an ex-officio member. Its purpose is to develop higher education, to administer the licensing and certification of institutions of higher education, and to administer scholarship funds. The Commonwealth provides financial support to PRCHE through legislative appropriations.

***Puerto Rico Government Investment Trust Fund (PRGITF)*** – PRGITF is governed by the Secretary of the Treasury of the Commonwealth. GDB is its trustee, custodian, and administrator. PRGITF's main objective is to provide investment opportunities in a professionally managed money market portfolio by investing in high-quality securities with minimal credit risk. Qualified investors include the Commonwealth's central government, its public corporations, instrumentalities and agencies, and the municipalities of Puerto Rico. In conformity with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*, the financial statements of the PRGITF are not included in the accompanying basic financial statements because the primary government and each component unit investor is already presenting as cash or investment their corresponding share of the assets of the PRGITF (see note 5).

***Puerto Rico Industrial Development Company (PRIDCO)*** – PRIDCO is governed by a seven-member board comprised of the Secretary of Economic Development and Commerce of the Commonwealth, who is the Chairman, the Secretary of the Treasury of the Commonwealth, the President of GDB, the President of the Planning Board of Puerto Rico, and three members from the private sector appointed by the Governor with the advice and consent of the Senate. The private sector members are appointed for a period of four years. PRIDCO administers the Commonwealth-sponsored economic development program by providing facilities, general assistance, and special incentive grants to manufacturing companies operating in Puerto Rico. PRIDCO has issued interim notes and revenue bonds to finance manufacturing plants and other facilities. Rentals derived from the leasing of specified facilities of PRIDCO are pledged for the payment of PRIDCO's revenue bonds. PRIDCO maintains debt that is paid with Commonwealth appropriations.



## COMMONWEALTH OF PUERTO RICO

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***Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority (known as AFICA by its Spanish acronym)*** – AFICA is governed by a seven-member board consisting of the Secretary of Economic Development and Commerce, the President of GDB, the Executive Director of PRIFA, the Executive Director of the Tourism Company of Puerto Rico, the President of the Environmental Quality Board, and two private citizens appointed by the Governor. AFICA is authorized to issue revenue bonds to finance industrial, tourist, environmental control, medical, and educational facilities in Puerto Rico and the United States for use by private companies, nonprofit entities, or governmental agencies. The bonds are payable solely from collections from such private companies, nonprofit entities, or governmental agencies, and do not constitute debt of the Commonwealth or any of its other component units. The Commonwealth has access to AFICA's resources. AFICA maintains debt that is paid with Commonwealth appropriations.

***Puerto Rico Land Administration (PRLA)*** – PRLA is governed by an eight-member board comprised of the Secretary of Economic Development and Commerce of the Commonwealth, who serves as president, the Secretary of the Treasury of the Commonwealth, the Secretary of Agriculture of the Commonwealth, the Secretary of DTPW of the Commonwealth, the Secretary of Housing of the Commonwealth, the President of the Planning Board of Puerto Rico, and two other members appointed by the Governor with the consent of the Senate. PRLA acquires parcels of land on behalf of government instrumentalities through negotiation or expropriation. The Commonwealth provides financial support to the PRLA through legislative appropriations.

***Puerto Rico Medical Services Administration (PRMSA)*** – PRMSA is governed by a ten-member board comprised of the Secretary of Health of the Commonwealth, who is the Chairman, the Dean of the Medical Sciences Faculty of the UPR, the President of the Board of the Puerto Rican Cancer Society, the Mayor of the Municipality of San Juan, the Administrator of the State Insurance Fund Corporation (SIFC), the Executive Director of PRMSA, the Administrator of the Administration of Mental Health and Anti-Addiction Services, the President of the Medical Policy and Administration Committee, and two consumers appointed by the Secretary of Health of the Commonwealth. Its purpose is to plan, organize, operate, and administer the centralized health services, provided in support of the hospital and other functions, offered by the member institutions and users of the medical complex known as the Puerto Rico Medical Center. The Commonwealth provides financial support to PRMSA through legislative appropriations.

***Puerto Rico Metropolitan Bus Authority (PRMBA)*** – PRMBA is governed by the Secretary of DTPW of the Commonwealth. PRMBA provides bus transportation to passengers within the San Juan Metropolitan Area. The Commonwealth provides financial support to PRMBA through legislative appropriations.

***Puerto Rico Municipal Finance Agency (PRMFA)*** – PRMFA is governed by a five-member board comprised of the President of GDB, who is the Chairman, the Commissioner of Municipal Affairs, and three additional members appointed by the Governor, one of whom shall be either the mayor or chief financial officer of a municipality. PRMFA was organized to create a capital market to assist the municipalities of Puerto Rico in financing their public improvement programs.

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### Notes to Basic Financial Statements

June 30, 2006

***Puerto Rico Ports Authority (PRPA)*** – PRPA is governed by a five-member board consisting of the Secretary of DTPW of the Commonwealth, who is the Chairman, the Secretary of Economic Development and Commerce of the Commonwealth, the Executive Director of PRIDCO, the Executive Director of the Puerto Rico Tourism Company, and one private citizen appointed by the Governor with the consent of the Senate. The purpose of PRPA is to administer all ports and aviation transportation facilities of the Commonwealth and to render other related services. The Commonwealth provides financial support to PRPA through legislative appropriations.

***Puerto Rico Public Broadcasting Corporation (PRPBC)*** – PRPBC is governed by an eleven-member board of directors comprised of the Secretary of Education of the Commonwealth, the President of the UPR, the Executive Director of IPRC, and eight private citizens, appointed by the Governor with the advice and consent of the Senate. At least three of these private citizens must have proven interest, knowledge, and experience in education, culture, art, science, or radio and television. PRPBC was created for the purpose of integrating, developing, and operating the radio, television, and electronic communication facilities that belong to the Commonwealth. The Commonwealth provides financial support to PRPBC through legislative appropriations.

***Puerto Rico School of Plastic Arts (PRSPA)*** – PRSPA is governed by a seven-member board. Four members are appointed by the board of directors of IPRC, representing the public educational and cultural interests. Board members may not be employees of the PRSPA. The remaining three members are elected from among the members of the board of directors of IPRC, one of whom will serve as president. PRSPA was created to develop, promote, plan, and coordinate programs of study in higher education oriented to the plastic arts, teaching, artistic techniques, and to help students to develop humanistic values. The Commonwealth provides financial support to PRSPA through legislative appropriations.

***Puerto Rico Solid Waste Authority (PRSWA)*** – PRSWA is governed by a government board appointed by the Secretary of the Department of Natural Resources, whereby, the Secretary and the Executive Director of PRSMA periodically meet. PRSWA provides alternatives for processing of solid waste and encourages recycling, reuse, and recovery of resources from waste. The Commonwealth provides financial support to PRSWA through legislative appropriations.

***Puerto Rico Telephone Authority (PRTA)*** – PRTA is governed by a five-member board comprised of the President of GDB and four members that are appointed by the board of directors of GDB. PRTA is the legal entity responsible to account for the equity interest in Telecomunicaciones de Puerto Rico, Inc. for the benefit of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities. The Commonwealth provides financial support to PRTA through legislative appropriations.

***Puerto Rico Tourism Company (PRTC)*** – PRTC is governed by a seven-member board comprised of representatives of different tourist-related sectors appointed by the Governor with the consent of the Senate. At least one member must represent internal tourism and two must not be residents of the metropolitan area. Its purpose is to promote the tourism industry of Puerto Rico. The Commonwealth provides financial support to PRTC through legislative appropriations.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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***Puerto Rico Trade and Export Company (PRTEC)*** – PRTEC is governed by an eight-member board comprised of the Secretary of Department of Economic Development and Commerce, who is the Chairman, the Executive Director of the Ports Authority, the Secretary of the Department of Agriculture, the President of EDB, the Executive Director of PRIDCO, the Legal Division Director of PRTEC, and two private citizens. PRTEC has the responsibility to promote the highest efficiency in the services provided to the commercial sector, with emphasis on small and medium-sized enterprises while promoting the export of products and services from Puerto Rico to other countries. The Commonwealth provides financial support to PRTEC through legislative appropriations.

***Right to Employment Administration (REA)*** – REA is governed by an administrator appointed by the Governor with the consent of the Senate. In addition, a consultative board comprised of the Secretary of Labor and Human Resources of the Commonwealth, the Secretary of Agriculture of the Commonwealth, the Secretary of the DTPW of the Commonwealth, the Secretary of Education of the Commonwealth, and five additional members appointed by the Governor, with the Consent of the Senate, will advise the administrator on the implementation of the Right to Employment Act. The Commonwealth provides financial support to REA through legislative appropriations.

***Special Communities Perpetual Trust (SCPT)*** – SCPT is governed by a board of directors composed of eleven members: the Secretary of Housing of the Commonwealth, the Secretary of the DTPW of the Commonwealth, the Coordinator for the Social and Economic Financing of the Special Communities, one mayor of the municipality of Puerto Rico, one community leader resident in one special community, four private citizens representing the public interest, and two public employees. All members of the Board of directors are appointed by the Governor. SCPT's principal purpose is to fund development projects that address the infrastructure and housing needs of the underprivileged communities. The Commonwealth of Puerto Rico provides financial support to SCPT through legislative appropriations.

***State Insurance Fund Corporation (SIFC)*** – SIFC is governed by a six-member board appointed by the Governor with the advice and consent of the Senate. The board is comprised of the Commissioner of Insurance of Puerto Rico, an officer from the Department of Labor and Human Resources of the Commonwealth, an officer from the Department of Health of the Commonwealth, a representative of the employer's interest, a representative of the employees' interest, and two members without any of these interests. One of these members is appointed by the Governor as president of the board for a period of six years. The three public officials are appointed for a period of five years, and the rest of the members for four, three, two, and one year, respectively. SIFC provides workers' compensation and disability insurance to public and private employees. The Commonwealth has access to SIFC's resources. Payments made by SIFC to the Commonwealth during the year ended June 30, 2006 amounted to approximately \$37.3 million.

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

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Complete financial statements of the discretely presented component units can be obtained directly by contacting their administrative offices:

Government Development Bank for Puerto Rico P.O. Box 42001 San Juan, PR 00940 – 2001	Puerto Rico Aqueduct and Sewer Authority P.O. Box 7066 San Juan, PR 00916-7066
Puerto Rico Electric Power Authority P.O. Box 364267 San Juan, PR 00936-4267	Puerto Rico Health Insurance Administration P.O. Box 195661 San Juan PR 00919-5661
Puerto Rico Highways and Transportation Authority P.O. Box 42007 San Juan, PR 00940-2007	Puerto Rico Infrastructure Financing Authority Capital Center 235 Ave. Arterial Hostos, Suite 1600 San Juan, PR 00918-1433
University of Puerto Rico Jardin Botanico Sur 1187 Calle Flamboyán San Juan, PR 00926-1117	Agricultural Services and Development Administration P.O. Box 9200 San Juan, PR 00908-0202
Automobile Accidents Compensations Administration P.O. Box 364847 San Juan, PR 00936-4847	Cardiovascular Center Corporation of Puerto Rico and the Caribbean P.O. Box 366528 San Juan, PR 00936-6528
Caribbean Basin Projects Financing Authority P.O. Box 42001 San Juan, PR 00940-2001	Culebra Conservation and Development Authority P.O. Box 217 Culebra, PR 00775-0217
Economic Development Bank for Puerto Rico P.O. Box 2134 San Juan, PR 00922-2134	Employment and Training Enterprises Corporation P.O. Box 366505 San Juan, PR 00936-6505
Farm Insurance Corporation of Puerto Rico P.O. Box 9200 Santurce, PR 00908	Fine Arts Center Corporation P.O. Box 41287 – Minillas Station San Juan, PR 00940-1287
Governing Board of the 9-1-1 Service P.O. Box 270200 San Juan, PR 00927-0200	Institutional Trust of the National Guard of Puerto Rico P.O. Box 9023786 San Juan, PR 00902-3786

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Land Authority of Puerto Rico  
P.O. Box 9745  
San Juan, PR 00908-9745

Musical Arts Corporation  
P.O. Box 41227 – Minillas Station  
San Juan, PR 00940-1227

National Parks Company of Puerto Rico  
P.O. Box 902098  
San Juan, PR 00902-2089

Public Corporation for the Supervision and  
Deposit Insurance of Puerto Rico Cooperatives  
P.O. Box 195449  
San Juan, PR 00919-5449

Puerto Rico Conservatory of Music Corporation  
350 Lamar Street and Roosevelt Avenue  
San Juan, PR 00918-2199

Puerto Rico Convention Center District Authority  
P.O. Box 19269  
San Juan, PR 00910-1269

Puerto Rico Council on Higher Education  
P.O. Box 19900  
San Juan, PR 00910-1900

Puerto Rico Government Investment Trust Fund  
P.O. Box 42001 – Minillas Station  
San Juan, PR 00940-2001

Puerto Rico Industrial Development Company  
P.O. Box 362350  
San Juan, PR 00936-2350

Puerto Rico Industrial, Tourist, Educational,  
Medical, and Environmental Control  
Facilities Financing Authority  
P.O. Box 42001  
San Juan, PR 00940-2001

Puerto Rico Land Administration  
P.O. Box 363767  
San Juan, PR 00936-3767

Puerto Rico Medical Services Administration  
P.O. Box 2129  
San Juan, PR 00922-2129

Puerto Rico Metropolitan Bus Authority  
P.O. Box 195349  
San Juan, PR 00919-5349

Puerto Rico Municipal Finance Agency  
P.O. Box 42001  
San Juan, PR 00940

Puerto Rico Ports Authority  
P.O. Box 362829  
San Juan, PR 00936-2829

Puerto Rico Public  
Broadcasting Corporation  
P.O. Box 19-0909  
San Juan, PR 00919-0909

Puerto Rico School of Plastic Arts  
P.O. Box 9021112  
San Juan, PR 00902-1112

Puerto Rico Solid Waste Authority  
P.O. Box 40285 – Minillas Station  
San Juan, PR 00940-0285

Puerto Rico Telephone Authority  
P.O. Box 42001  
San Juan, PR 00940-2001

Puerto Rico Tourism Company  
P.O. Box 902-3960  
Old San Juan Station  
San Juan, PR 00902-3960

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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Puerto Rico Trade and Export Company  
P.O. Box 195009  
San Juan, PR 00919-5009

Right to Employment Administration  
P.O. Box 364452  
San Juan, PR 00936-4452

Special Communities  
Perpetual Trust  
P.O. Box 42001  
San Juan, PR 00940-2001

State Insurance Fund  
Corporation  
P.O. Box 365028  
San Juan, PR 00936-5028

The financial statements of the discretely presented component units have a year-end of June 30, 2006, except for the Puerto Rico Telephone Authority, which has a year-end of December 31, 2005.

#### **Fiduciary Component Units**

The three employee retirement systems administer pension funds for the Commonwealth and its political subdivisions. The three systems are subject to legislative and executive controls, and the administrative expenses are subject to legislative budget controls. These component units, while meeting the definition of a component unit and are legally separate, are presented in the fund financial statements along with other fiduciary funds of the Commonwealth. They have been omitted from the government-wide financial statements.

***Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS)*** – ERS is governed by a board of trustees, which is composed of the Secretary of the Treasury of the Commonwealth, who is the President, the President of GDB, the Commissioner for Municipal Affairs, the Director of the Puerto Rico Central Office of Personnel Administration, two participating employees, and one retiree, who are appointed by the Governor. The Commonwealth reports ERS as a single-employer pension plan. ERS is the administrator of a defined-benefit pension plan, which covers all regular employees of the Commonwealth and its instrumentalities and of certain municipalities and component units not covered by their own retirement systems. On September 24, 1999, an amendment to the law that created ERS was enacted with the purpose of establishing a new defined-contribution plan (System 2000) for employees hired by the government on or after January 1, 2000.

***Puerto Rico Judiciary Retirement System (JRS)*** – JRS is governed by the same board of trustees as ERS. JRS is a single-employer defined-benefit plan, administered by ERS, which covers all individuals holding a position as Justice of the Supreme Court, Judge of the Superior Court or the District Court, or Municipal Judges of the Commonwealth.



## COMMONWEALTH OF PUERTO RICO

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***Puerto Rico System of Annuities and Pensions for Teachers (TRS)*** – TRS is governed by a nine member board comprised of the Secretary of Education of the Commonwealth, the Secretary of the Treasury of the Commonwealth, the President of GDB, two active teachers (one of them is a representative of the teachers' organization according to Act No. 45 of February 1998), two retired teachers, one representative of the teachers' organization and one representative of the public interest appointed by the Governor with the advice and consent of the Senate for four years. The Commonwealth reports TRS as a single-employer pension plan. TRS provides retirement benefits to all teachers of the Department of Education of the Commonwealth, all pensioned teachers, all teachers transferred to an administrative position in the Department of Education of the Commonwealth, teachers who work in the Teachers' Association of Puerto Rico, and those who practice in private institutions accredited by the Department of Education of the Commonwealth. TRS provides retirement, death, and disability benefits.

Complete financial statements of these component units can be obtained directly by contacting their respective administrative offices at:

Employees' Retirement System of the  
Government of Puerto Rico and its  
Instrumentalities  
P.O. Box 42003 – Minillas Station  
Santurce, PR 00940

Puerto Rico Judiciary  
Retirement System  
P.O. Box 42003 – Minillas Station  
Santurce, PR 00940

Puerto Rico System of Annuities and Pensions for  
Teachers  
P.O. Box 191879  
San Juan, PR 00919-1879

#### (c) ***Government-wide Financial Statements***

The government-wide financial statements (the statement of net assets and the statement of activities) report information of all of the nonfiduciary activities of the Commonwealth and its component units. For the most part, the effect of interfund activity has been removed from these government-wide financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenue, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported separately from the legally separate component units for which the primary government is financially accountable. The statement of net assets presents the reporting entities' nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- ***Invested in Capital Assets, Net of Related Debt*** – These consist of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.

## COMMONWEALTH OF PUERTO RICO

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- ***Restricted Net Assets*** – These result when constraints placed on net assets use on either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

The government-wide statement of net assets reports \$1,195,559 of restricted net assets, none restricted by enabling legislation.

- ***Unrestricted Net Assets*** – These consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources that are imposed by management, but can be removed or modified.

When both restricted and unrestricted resources are available for use, generally it is the Commonwealth's policy to use restricted resources first, then the unrestricted resources as they are needed.

The statement of activities demonstrates the degree to which the direct expenses of a given function, segment, or component unit are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function, segment, or component unit. Program revenue includes charges to customers who purchase, use, or directly benefit from goods or services provided by a given function, segment, or component unit. Program revenue also includes grants and contributions that are restricted to meeting the operational or capital requirements of a particular function, segment, or component unit. Taxes and other items not properly included among program revenue are reported instead as general revenue. Resources that are dedicated internally are reported as general revenue rather than as program revenue. The Commonwealth does not allocate general government (indirect) expenses to other functions.

**(d) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation***

***Government-wide Financial Statements*** – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

***Governmental Fund Financial Statements*** – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified-accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Commonwealth considers revenue to be available if collected within 120 days after the end of the current fiscal year-end. Principal revenue sources considered susceptible to accrual include tax revenue, net of estimated overpayments (refunds) and amounts considered not collectible, which are recorded as taxpayers earn income (income taxes), as sales are made (consumption and use taxes), and as cash is received (miscellaneous taxes). In applying the susceptible to accrual concept to federal grants, there are essentially two types of revenue. For the majority of grants, moneys must be expended by the



## COMMONWEALTH OF PUERTO RICO

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Commonwealth on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For the other revenue, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements. These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

- Employees' vested annual vacation and sick leave are recorded as expenditures when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2006 has been reported only in the government-wide financial statements.
- Interest and principal on general long-term obligations are recorded when due, except for interest and principal due on July 1 of the following fiscal year, if resources are available for its payment as of June 30.
- Executory purchase orders and contracts are recorded as a reservation of fund balance.
- Debt service expenditures, federal funds cost disallowances, other long-term obligations, and amounts subject to judgments under litigation are recorded only when payment is due.

***Proprietary Funds, Fiduciary Funds, and Discretely Presented Component Units Financial Statements*** – The financial statements of the proprietary funds, fiduciary funds, and discretely presented component units are reported using the economic measurement focus and the accrual basis of accounting, similar to the government-wide financial statements described above.

Each enterprise fund has the option under GASB Statement No. 20 to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless these conflict with a GASB pronouncement. The primary government's major enterprise funds have elected not to apply FASB pronouncements issued after November 30, 1989 and two nonmajor enterprise funds elected to adopt the FASB's pronouncements issued after November 30, 1989. Also, certain discretely presented component units have disclosed their election in their separately issued financial statements. The component units follow U.S. GAAP as issued by GASB and FASB as applicable to each component unit based on the nature of their operations. In addition, the Puerto Rico Government Investment Trust Fund adopted GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investments Pools*; however, such financial statements are not included in the accompanying basic financial statements because the primary government and each component unit's investor already present their corresponding share of the assets of the PRGITF as cash or investments.

## COMMONWEALTH OF PUERTO RICO

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Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses. The major operating revenue of the Commonwealth enterprise funds is as follows:

- Unemployment Insurance Trust Fund – Amounts requisitioned for the Puerto Rico Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits and charges made to individual employers.
- Lotteries Fund – Amounts collected from the sale of traditional lottery tickets and electronic lotto games.

#### (e) *Fund Accounting*

The Commonwealth reports its financial position and results of operations in funds, which are considered separate accounting entities, and discrete presentations of those component units, which are not required to be blended. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. Major funds are determined using a predefined percentage of the assets, liabilities, revenue, or expenditures/expenses of either the fund category or the governmental and enterprise funds combined. The nonmajor funds are combined in a single column in the fund financial statements. The Commonwealth reports the following major funds:

#### **Governmental Funds**

**General Fund** – The general fund is the primary operating fund of the Commonwealth. It is used to account for all financial transactions, except those required to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, and education.

**Debt Service Fund** – The debt service fund accounts for the accumulation of resources predominantly for, and the payment of, general long-term bonds' principal, interest and related costs other than bonds payable from the operations of proprietary fund types, pension trust funds, and discretely presented component units. Long-term debt and interest due on July 1 of the following fiscal year are accounted for as a fund liability if resources are available as of June 30 for its payment.

**Public Buildings Authority's Capital Projects Fund** – The Public Buildings Authority's capital projects fund is used to account for the financial resources used for the acquisition or construction of major capital facilities not financed by proprietary fund types, pension trust funds, and discretely presented component units.

**The Children's Trust Special Revenue Fund** – The Children's Trust special revenue fund is used to account for the moneys received by the Commonwealth from a global settlement agreement dated November 23, 1998, between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The financial resources

## COMMONWEALTH OF PUERTO RICO

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received by this fund are used to carry out projects aimed at promoting the well-being of children and youth of Puerto Rico.

#### **Proprietary Funds**

These funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to the general public.

*Unemployment Insurance Trust Fund* – This fund accounts for amounts requisitioned for the Puerto Rico Unemployment Insurance Trust Fund held by the U.S. Treasury for payment of unemployment benefits and charges made to individual employers.

*Lotteries Fund* – This fund accounts for the assets and operations of two lottery systems administered by the Commonwealth.

#### **Fiduciary Funds**

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity, or as an agent for individuals, private organizations, and other governmental units. The following are the Commonwealth's fiduciary funds:

*Pension Trust Funds* – These are used to account for the assets, liabilities, and net assets available for pension benefits held in trust for the public employees' retirement systems.

*Agency Funds* – These are custodial in nature (assets equal liabilities) and do not involve measurement of the results of operations.

#### **Discretely Presented Component Units**

Discrete presentation of component units is used to present the financial information of entities that do not qualify to be blended, in accordance with GASB No. 14, with the funds of the primary government. The component units column in the government-wide financial statements is used to report the financial activities of the Commonwealth's discretely presented component units. The financial statements of these component units are presented following the accrual basis of accounting. Under the accrual basis, revenue is recognized when earned and expenses are recorded as liabilities when incurred, without regard to receipt or payment of cash.

#### **(f) *Statutory (Budgetary) Accounting***

The Commonwealth's budget is adopted in accordance with a statutory basis of accounting, which is not in accordance with GAAP. Revenue is generally recognized when cash is received, net of tax refunds claimed by taxpayers as of year-end. Short-term and long-term borrowings may be used to finance budgetary excess of expenditures over revenue. Expenditures are generally recorded when the related expenditure is incurred or encumbered. Encumbrances lapse the year following the end of the fiscal year when the encumbrance was established, as established by Act No. 123 of August 17, 2001, which amended the then existing appropriations and encumbrances lapsing provisions of Act No. 230 of July 23, 1974. Unencumbered appropriations lapse at year-end. Amounts required for settling claims and judgments against the Commonwealth and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment.

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Under the statutory basis of accounting, the Commonwealth uses encumbrance accounting to record the full amount of purchase orders, contracts, and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control.

The statement of revenue and expenditures – budget and actual – budget basis – general fund, only presents the information for the general fund for which there is a legally adopted budget, as required by GAAP. See note 3 for a reconciliation of the statement of revenue and expenditures – budget and actual – budget basis – general fund with the statement of revenue, expenditures, and changes in fund balance (deficit) for the general fund. The special revenue funds do not have a legally mandated budget.

#### **(g) *Cash and Short-term Investments***

The Commonwealth follows the practice of pooling cash. The balance in the pooled cash accounts is available to meet current operating requirements, and any excess is invested in various interest bearing accounts with GDB and with the PRGITF. At June 30, 2006, excess of checks drawn over the pooled bank balance amounted to approximately \$1.4 billion and is reported within accounts payable and accrued liabilities of the governmental activities.

Cash and cash equivalents include investments with original maturities of 90 days or less from the date of acquisition.

The Commissioner of Financial Institutions requires that private financial institutions deposit collateral securities to secure the deposits of the Commonwealth and all other governmental entities in each of these institutions. The amount of collateral securities to be pledged for the security of public deposits shall be established by the rules and regulations promulgated by the Commissioner of Financial Institutions.

The Puerto Rico Unemployment Insurance Trust Fund is maintained to account for the collection of unemployment insurance contributions from employers and the payment of unemployment benefits to eligible claimants. As required by federal law, all resources not necessary for current benefit payments are placed on deposit with the U.S. Treasury. Interest earned over such deposit is retained in the fund.

Cash and short-term investments and cash equivalents of the component units are maintained in separate bank accounts, from those of the primary government, in their own names.

#### **(h) *Securities Purchased Under Agreements to Resell***

Certain component units of the Commonwealth enter into purchases of securities with simultaneous agreements to resell. The securities underlying these agreements mainly consist of U.S. government obligations, mortgage-backed securities, and interest-bearing deposits with other banks.

#### **(i) *Securities Lending Transactions***

Certain component units of the Commonwealth enter into securities lending transactions in which governmental entities (lenders) transfer their securities to broker-dealers and other entities

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(borrowers) for collateral with a simultaneous agreement to return the collateral for the same securities in the future. Securities received as collateral are generally reflected as investments with a corresponding liability resulting from the obligation to return such collateral.

**(j) Investments**

Investments include U.S. government and agencies obligations, mortgage-backed securities, repurchase agreements, commercial paper, local government obligations, investment contracts, and corporate debt and equity obligations. Investment securities, including investments in limited partnerships, are presented at fair value, except for money market investments and participating investment contracts with a remaining maturity at the time of purchase of one year or less and nonparticipating investment contracts, which are presented at cost. Changes in the fair value of investments are presented as investment earnings in the statement of activities, the statement of revenue, expenditures, and changes in balance – governmental funds, and the statement of revenue, expenses, and changes in fund net assets – proprietary funds. Fair value is determined based on quoted market prices. When securities are not listed on national exchanges, quotations are obtained from brokerage firms.

The PRGITF is considered a 2a7-like external investment pool and, as such, reports its investments at amortized cost.

The reverse repurchase agreements reported by certain discretely presented component units are authorized transactions under their respective enabling legislation and authorized by GDB.

**(k) Receivables**

Tax receivables in the general fund include predominantly amounts owed by taxpayers for individual and corporate income taxes, net of estimated uncollectible amounts. Income tax receivables are recognized as revenue when they become measurable and available based on actual collections during the 120 days following the fiscal year-end related to tax returns due before year-end. Tax receivables also include amounts owed by taxpayers on income earned in periods prior to June 30, 2006, estimated to be collectible but not currently available, and thus are reported as deferred revenue in the general fund. Unemployment, disability, and driver's insurance receivables in the enterprise funds are stated net of estimated allowances for uncollectible accounts.

Accounts receivable are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience and current economic conditions. Intergovernmental receivables primarily represent amounts owed to the Commonwealth for reimbursement of expenditures incurred pursuant to federally funded programs. Intergovernmental receivables also include taxes that the Municipal Revenue Collection Center (CRIM, as per its Spanish acronym), a municipal corporation, is required to remit to the Commonwealth to be used by the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth. The amount to be remitted is based on the special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation, which is levied by the CRIM [see note 14(c)].



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The accounts receivable from nongovernmental customers of the component units are net of estimated uncollectible amounts. These receivables arise primarily from service charges to users. Accounts receivable from the primary government and other component units that arise from service charges do not have allowances for uncollectible accounts, as these are deemed fully collectible.

Loans of the general fund represent predominantly amounts owed by public corporations and municipalities for public insurance and rent paid by the general fund on their behalf.

The loans of the pension trust funds do not have allowances for uncollectible amounts since such loans are secured by mortgage deeds, plan members' contributions, and any unrestricted amounts remaining in escrow. Loans of the component units consist predominantly of loans to the primary government, other component units and municipalities, and do not have allowances for uncollectible accounts as those are deemed fully collectible. The remaining loans of the component units are to small and medium businesses, agricultural, and low-income housing loans from nongovernmental customers, and are presented net of estimated losses on such portfolios.

**(l) Inventories**

Generally, inventories are valued at cost and predominantly on the first-in, first-out basis. Governmental fund inventories are recorded as expenditures when purchased rather than capitalized as an asset. Only significant amounts of inventory at the end of the year are capitalized in the governmental funds. However, inventories are always capitalized in the statement of net assets of governmental activities.

**(m) Restricted Assets**

Funds set aside for the payment and guarantee of notes and interest payable and for other specified purposes are classified as restricted assets since their use is limited for this purpose by applicable agreements or required by law. Restricted assets in the proprietary funds mainly include amounts set aside for the payment of insurance benefits.

**(n) Real Estate Held for Sale**

Real estate held for sale are carried at the lower of fair value or cost, which is established by a third party professional assessment or based upon an appraisal, minus estimated costs to sell. Subsequent declines in the value of real estate available for sale are charged to expenditure/expense.

**(o) Capital Assets**

Capital assets, which include land, buildings, building improvements, equipment, vehicles, construction in process, and infrastructure assets, are reported in the applicable governmental, business-type activities and component unit columns in the government-wide financial statements. The Commonwealth's primary government defines capital assets as assets that have an initial, individual cost of \$25,000 or more at the date of acquisition and have a useful life of five or more years. Capital assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available.

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The method to deflate the current cost of the same or a similar asset using an approximate price index was used to estimate the historical cost of certain land, buildings, and building improvements because invoices and similar documentation was no longer available in certain instances. Donated capital assets are recorded at fair market value at the time of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest costs are capitalized during the construction period only for business-type activities and most component units. The costs of normal maintenance and repairs that do not add value to the assets or materially extend asset lives are not capitalized.

GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, provides transition standards that make available an extended period of deferral (fiscal year 2006) before the requirement to record and depreciate general infrastructure assets acquired before implementation date (July 1, 2001) becomes effective. General infrastructure assets acquired prior to July 1, 2001 were recorded during the fiscal year ended June 30, 2006.

Capital assets utilized in the governmental funds are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds and component units' financial statements.

Capital assets of the primary government are depreciated on the straight-line method over the assets' estimated useful life. There is no depreciation recorded for land and construction in progress. The estimated useful life of capital assets is as follows:

	<u>Years</u>
Buildings and building improvements	20 – 50
Equipment, furniture, fixtures, and vehicles	5 – 15
Infrastructure	50

The capital assets of the component units are recorded in accordance with the applicable standards of the component units and under their own individual capitalization thresholds. Depreciation has been recorded when required by these standards based on the types of assets, use and estimated useful lives of the respective assets, and on the nature of each of the component unit's operations.

The estimated useful lives of capital assets reported by the component units are as follows:

	<u>Years</u>
Buildings and building improvements	3 – 50
Equipment, furniture, fixtures, and vehicles	3 – 20
Infrastructure	10 – 50

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The Commonwealth adopted the provision of GASB Statement No. 42 *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, an amendment to GASB Statement No. 34. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

**(p) Tax Refunds Payable**

During the calendar year, the Commonwealth collects individual income taxes through withholdings and payments from taxpayers. At June 30, the Commonwealth estimates the amount owed to taxpayers for overpayments during the first half of the calendar year. These estimated amounts and the actual tax refunds claimed for prior years but not paid at year-end are recorded as tax refunds payable and as a reduction of tax revenue.

**(q) Deferred Revenue**

Deferred revenue at the governmental fund level arises when potential revenue does not meet either the “measurable” or the “available” criteria for revenue recognition in the current period. Deferred revenue also arises when resources are received before the Commonwealth has a legal claim to them, as when grant moneys are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Commonwealth has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and the revenue is recognized. Deferred revenue at the government-wide and proprietary fund levels arises only when the Commonwealth receives resources before it has a legal claim to them.

**(r) Long-term Debt**

The liabilities reported in the government-wide financial statements include Commonwealth general obligation bonds and long-term notes, obligations under lease/purchase agreements, and long-term liabilities including vacation, sick leave, long-term liabilities to other governmental entities, net pension obligation, legal claims, and noncurrent federal fund cost disallowances related to expenditures of federal grants. Long-term obligations financed by proprietary fund types and component units are recorded as liabilities in those funds and in the discretely presented component units column.

Premiums, discounts, and issuance costs – in the government-wide financial statements, long-term debt and other long-term obligations are presented in the columns for governmental and business-type activities. The same is presented in the proprietary fund financial statements. Bond and note premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the debt. Bonds and notes payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges in other assets and are amortized over the term of the related debt. In the governmental fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures.



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**(s) *Reservations of Fund Balance – Governmental Funds***

The governmental fund financial statements present fund balance reserves for those portions of fund balance (1) not available for appropriation for expenditures or (2) legally segregated for a specific future use. Reserves for encumbrances, debt service, and other specific purposes are examples of the latter.

**(t) *Accounting for Pension Costs***

For the purpose of applying the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*, the Commonwealth's financial reporting entity is considered to be a sponsor of three single-employer defined-benefit pension plans: ERS, JRS, and the TRS. This is because substantially all the participants in the three pension trust funds are part of the financial reporting entity of the Commonwealth. For the purpose of the basic financial statements, and as disclosed in note 19, the Commonwealth's annual pension cost, measured on the accrual basis of accounting, for the year ended June 30, 2006 amounted to approximately \$866 million. However, the amount recognized as pension expenditure in the governmental funds was recorded under the modified-accrual basis, and amounted to approximately \$602 million. The excess of the annual required contribution over the statutorily required contributions increased the net pension obligation at June 30, 2006 to approximately \$4.7 billion. This amount is presented in the statement of net assets of the governmental activities as of June 30, 2006.

For purposes of the stand-alone financial statements of each of the blended and discretely presented component units, the entities accounted for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized are equal to the statutorily or contractually required contributions, with a liability recorded for any unpaid required contributions. The basis of accounting used by the component units was either modified-accrual basis or accrual basis, depending upon individual fund structure and type of entity. Most component units did not have pension-related assets or liabilities at transition because they have contributed the statutorily required contributions.

**(u) *Post-employment Benefits***

In addition to the pension benefits described in note 19, the Commonwealth provides post-employment healthcare benefits and a Christmas bonus for its retired employees in accordance with local law. Substantially all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Commonwealth. Healthcare benefits are provided through insurance companies whose premiums are paid by the retiree with the Commonwealth providing a matching share of not more than \$100 per month for each retiree. During the year ended June 30, 2006, the cost of providing healthcare benefits amounted to approximately \$148 million for approximately 123,534 retirees. The Christmas bonus paid to these retired employees during the year ended June 30, 2006 was \$400 per retiree and the total amount was approximately \$49.4 million. These benefits are recorded as expenditures when paid in the general fund.

**(v) *Compensated Absences***

The vacation policy of the Commonwealth generally provides for the accumulation of 2.5 days per month, except for the teachers who accrue 4 days per month. Vacation time accumulated is fully

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vested to the employees from the first day of work up to a maximum of 60 days. Employees accumulate sick leave generally at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated unpaid leave at the current rate, if the employee has at least 10 years of service with the Commonwealth. Accrued compensated absences of the primary government at June 30, 2006 amounting to approximately \$1.7 billion are presented in the statement of net assets. Compensated absence accumulation policies for the blended component units and discretely presented component units vary from entity to entity based on negotiated agreements and other factors agreed upon between the management of these entities and their employees.

The Public Service Personnel Law requires certain component units and the primary government of the Commonwealth to annually pay the employees the accumulated vacation and sick leave earned in excess of the limits mentioned above.

#### (w) *Interfund and Intraentity Transactions*

The Commonwealth has the following types of transactions among funds:

***Interfund Transfer*** – Legally required transfers that are reported when incurred as transfer-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these transfers and related amounts receivable and payable are considered internal balances and activities that have been eliminated in the government-wide financial statements.

***Intraentity Transactions*** – There are two types of intraentity transactions. First, are resource flows between the primary government and its component units and among the component units. These resource flows and related outstanding balances are reported as if they were external transactions. However, resource flows between the primary government and blended component units are classified as interfund transactions, as described above. Second, are intraentity balances between the primary government funds and discretely presented component units that are tantamount to long-term debt financing. The primary government's liability is reported in the statement of net assets, the proceeds in the primary government's funds, and the asset in the discretely presented component units' statement of net assets.

#### (x) *Lottery Revenue and Prizes*

The revenue, expenses, and prizes awarded by the Lottery of Puerto Rico and the Additional Lottery System, reported within the lotteries enterprise fund, are recognized as drawings are held. Moneys collected prior to June 30 for tickets related to drawings to be conducted subsequent to June 30 are reported as deferred revenue. Unpaid prizes awarded as of June 30 are reported as a fund liability.

#### (y) *Risk Management*

The Commonwealth purchases commercial insurance covering casualty, theft, tort claims, and other losses for the primary government, most component units, and the municipalities. The Commonwealth is reimbursed for premium payments made on behalf of the component units and the municipalities. The current insurance policies have not been canceled or terminated. For workers'

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compensation, the Commonwealth has a discretely presented component unit, the SIFC, which provides workers' compensation to both public and private employees. In the past three years, the Commonwealth has not settled claims that exceed insurance coverage.

Certain component units combine commercial insurance with internal self-insurance funds covering specific risks related to their specialized operations.

**(z) *GASB Technical Bulletin No. 2004-1***

The Children's Trust (the Trust) follows GASB Technical Bulletin No. 2004-1, Tobacco Settlement Recognition and Financial Reporting Entity Issue (the TB), which provides accounting guidance for entities created to obtain the rights to all or a portion of future tobacco settlement resources and for the governments that create such entities.

The TB indicates that the entity created to obtain the rights, which is called the Tobacco Settlement Authority (TSA), should be considered a component unit of the government that created it and the component unit should be blended. The TB also states that the government receiving the payments from the tobacco companies under the Agreement, which are called settling governments, should recognize a receivable and revenue for tobacco settlement resources (TSRs) when an event occurs. The event that results in the recognition of an asset and revenue by the settling government is the domestic shipment of cigarettes. The TB indicates that accruals should be made by the settling government and TSAs for estimates for estimated shipments from January 1 to their respective fiscal year-ends, since the annual payments are based on a calendar year. However, under the modified-accrual basis of accounting at the fund level, revenue should be recognized only to the extent that resources are available.

**(aa) *Reclassifications***

Certain reclassifications have been made to the information presented in the separately issued financial statements of certain blended component units and agencies included within the special revenue, debt service, capital projects, proprietary funds, and discretely presented component units to conform to the accounting classifications used by the Commonwealth in the basic financial statements.

**(bb) *Use of Estimates***

The preparation of the basic financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

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#### (cc) *Future Adoption of Accounting Pronouncements*

The GASB has issued the following accounting standards that have effective dates after June 30, 2006:

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions*, which is effective for fiscal years beginning after December 15, 2006.
- GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*, which is effective for periods ending after December 31, 2007.
- GASB Technical Bulletin No. 2004-2, *Recognition of Pensions and Other Post-employment Benefit Expenditures/Expense and Liability by Cost-Sharing Employers*. As it relates to pension transactions, this Technical Bulletin is effective for financial statements for periods ending after December 15, 2004. As it relates to OPEB transactions, it is effective for financial statements for periods beginning after December 15, 2006. The effect of this Technical Bulletin on the accompanying basic financial statements was not considered material as it relates to pension transactions.

The impact of these statements on the Commonwealth's basic financial statements has not yet been determined.

#### (2) **Component Units**

The Commonwealth follows the provisions of GASB No. 14. The basic financial statements of the Commonwealth include the financial statements of the following component units that were audited by other auditors:

Blended component units:

Public Buildings Authority  
Puerto Rico Maritime Shipping Authority  
The Children's Trust

Discretely presented component units:

Agricultural Services and Development Administration  
Automobile Accidents Compensations Administration  
Cardiovascular Center Corporation of Puerto Rico and the Caribbean  
Caribbean Basin Projects Financing Authority  
Culebra Conservation and Development Authority  
Employment and Training Enterprises Corporation  
Farm Insurance Corporation of Puerto Rico  
Fine Arts Center Corporation  
Governing Board of the 9-1-1 Service  
Government Development Bank for Puerto Rico

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Institutional Trust of the National Guard of Puerto Rico  
Land Authority of Puerto Rico  
Musical Arts Corporation  
National Parks Company of Puerto Rico  
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives  
Puerto Rico Conservatory of Music Corporation  
Puerto Rico Convention Center District Authority  
Puerto Rico Council on Higher Education  
Puerto Rico Electric Power Authority  
Puerto Rico Government Investment Trust Fund  
Puerto Rico Health Insurance Administration  
Puerto Rico Highways and Transportation Authority  
Puerto Rico Industrial Development Company  
Puerto Rico Industrial, Tourist, Educational, Medical, Environmental  
Control Facilities Financing Authority  
Puerto Rico Infrastructure Financing Authority  
Puerto Rico Land Administration  
Puerto Rico Medical Services Administration  
Puerto Rico Metropolitan Bus Authority  
Puerto Rico Municipal Finance Agency  
Puerto Rico Ports Authority  
Puerto Rico Public Broadcasting Corporation  
Puerto Rico School of Plastic Arts  
Puerto Rico Solid Waste Authority  
Puerto Rico Trade and Export Company  
Puerto Rico Telephone Authority  
Right to Employment Administration  
Special Communities Perpetual Trust  
State Insurance Fund Corporation  
University of Puerto Rico

### (3) Stewardship, Compliance, and Accountability

#### (a) *Budgetary Control*

The Governor is constitutionally required to submit to the Legislature an annual balanced budget of the Commonwealth for the ensuing fiscal year. The annual budget is prepared by the Commonwealth's Office of Management and Budget (OMB) and takes into consideration the advice provided by the Puerto Rico Planning Board (annual economic growth forecasts, and four-year capital improvements plan), the Department of the Treasury of the Commonwealth (revenue estimates, accounting records, and the comprehensive annual financial report), GDB (fiscal agent), and other governmental offices and agencies. Section 7 of Article VI of the Constitution of Puerto Rico provides that "The appropriations made for any fiscal year shall not exceed the total revenue, including available surplus, estimated for said fiscal year, unless the imposition of taxes sufficient to cover said appropriations is provided by law."

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The annual budget, which is developed utilizing elements of performance-based program budgeting and zero-based budgeting, includes an estimate of revenue and other resources for the ensuing fiscal year under: (1) laws existing at the time the budget is submitted; and (2) legislative measures proposed by the Governor and submitted with the proposed budget, as well as the Governor's recommendations as to appropriations that in his judgment are necessary, convenient, and in conformity with the four-year capital improvements plan adopted by the Puerto Rico Planning Board.

The Legislature may amend the budget submitted by the Governor but may not increase any items so as to cause a deficit without imposing taxes or identifying other sources of revenue to cover such deficit. Upon approval by the Legislature, the budget is referred to the Governor who may decrease or eliminate any line item but may not increase or insert any new line item in the budget. The Governor may also veto the budget in its entirety and return it to the Legislature with his objections. The Legislature, by two-thirds majority in each house, may override the Governor's veto. If a budget is not adopted prior to the end of the fiscal year, the annual budget for the preceding fiscal year, as approved by the Legislature and the Governor, is automatically renewed for the ensuing fiscal year until a new budget is approved by the Legislature and the Governor. This permits the Commonwealth to continue making payments for its operating and other expenses until the new budget is approved. The appropriated annual budget for fiscal year 2006 amounted to approximately \$5.5 billion. The Legislature also made several special budgetary appropriations to the general fund throughout the year, which amounted to approximately \$3.4 billion.

The OMB has authority to amend the budget within a department, agency, or government unit without legislative approval.

For budgetary purposes, encumbrance accounting is used. The encumbrances (that is, purchase orders, contracts) are considered expenditures when a commitment is made. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as reservations of budgetary appropriations within GAAP fund balances and do not constitute expenditures or liabilities on a GAAP basis because the commitments will be honored during the subsequent year. The unencumbered balance of any appropriation of the general fund at the end of the fiscal year lapses immediately. Appropriations, other than in the general fund, are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

In addition, the Legislature may direct that certain revenue be retained and made available for spending within a specific appropriation account. Generally, expenditures may not exceed the level of spending authorized for an individual department. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated. Appropriations are enacted for certain departments, agencies, and government units included in the balance sheet of the general fund. For these funds, a statement of revenue and expenditures – budget and actual budget basis – general fund is included. Appropriations for capital projects are made for each bond issue and the authorization continues for the expected construction period.

The Commonwealth's Department of the Treasury and OMB have the responsibility to ensure that budgetary spending control is maintained on an individual department basis. OMB may transfer part



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or all of any unencumbered balance within a department to another department subject to legislative approval. Budgetary control is exercised through the Puerto Rico Integrated Financial Accounting System (PRIFAS). PRIFAS ensures that encumbrances or expenditures are not processed if they exceed the department's total available spending authorization, which is considered its budget. The legal level of budgetary control is at the individual department level for general fund expenditures, principal and interest due for the year for the debt service fund, and by bond authorization for capital expenditures.

**(b) Budget/GAAP Reconciliation**

The following schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of entity, timing, and basis differences in the excess (deficiency) of revenue and other financing sources over expenditures and other financing uses for the year ended June 30, 2006 is presented below for the general fund (expressed in thousands):

Deficiency of revenue and other financing sources over expenditures and other financing uses – budget basis	\$ (461,241)
Entity differences:	
Excess (deficiency) of revenue and other financing sources over expenditures and other financing uses for:	
Non-budgeted funds	402,864
Inclusion of agencies with independent treasuries	(66,354)
Timing differences:	
Adjustment for encumbrances	39,370
Current year expenditure against prior year encumbrances	(30,718)
Basis of accounting differences:	
Net increase in taxes receivable (net of tax refunds)	108,079
Net increase in other receivables	90,580
Net decrease in deferred revenue	37,802
Excess of revenue and other financing sources over expenditures and other financing uses (GAAP basis)	\$ <u>120,382</u>

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### (c) *Deficit Net Assets*

The following activities, funds, and discretely presented component units reflect deficit fund balance/net assets at June 30, 2006 (expressed in thousands):

#### Primary government:

Governmental activities	\$ 17,209,563
General fund	\$ 383,755
PBA capital projects fund	\$ 32,026
Enterprise fund – lotteries	\$ 170,007

#### Component units:

Land Authority of Puerto Rico	\$ 124,912
Agricultural Services Development Administration	\$ 107,674
Puerto Rico Medical Services Administration	\$ 48,264
Cardiovascular Center Corporation of Puerto Rico and the Caribbean	\$ 32,889
Employment and Training Enterprises Corporation	\$ 6,034
Right to Employment Administration	\$ 2,527
Musical Arts Corporation	\$ 950

The Commonwealth's governmental activities show a deficit of approximately \$17.2 billion, mostly attributed to long-term obligations amounting to approximately \$26 billion, which is recognized in the statement of net assets. On the other hand, the discretely presented component units report net assets of approximately \$13.1 billion. This inverse relationship between the governmental activities and component units' net assets reveal the operational structure of the Commonwealth where the primary government issues debt, the proceeds of which are predominantly transferred to the component units and to other governments as well, to finance their capital projects and other operational needs. The Commonwealth includes within the annual budgetary appropriation process the necessary funds to cover the annual debt service requirements of the aforementioned debt, most of which are the result of Act No. 164 of December 17, 2001, described in note 14(d). Also, as part of the fiscal reform referred to below, certain component units will be subject to reductions in future legislative appropriations provided by the primary government, requiring the affected component units to increase their revenue base and fee structure currently being charged to the general public.

In an effort to address the Commonwealth's structural budget imbalance and its other fiscal difficulties, the Executive Branch and the Legislative Assembly enacted and the Governor signed legislation providing for tax reform and fiscal reforms. The tax reform legislation is aimed at increasing revenues by expanding the tax base through the implementation of a broad-based sales tax. The fiscal reform legislation is aimed at limiting expenditures in relation to past spending rates and stabilizing expenditure growth at a level below that of recurring revenues.



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On July 4, 2006 the legislative assembly approved Act No. 117 (Act 117) which amends the Puerto Rico Internal Revenue Code of 1994 (the PR Code) to provide, among other things, for a general sales and use tax of 5.5% to be imposed by the central government (the Central Government Sales Tax). Act 117 also authorizes each municipal government to impose a municipal sales and use tax of 1.5% (the Municipal Sales Tax and, together with the Central Government Sales Tax, the Sales Tax). In general, the Municipal Sales Tax has the same tax base, exemptions (except for unprocessed foods), and limitations as those provided for the Central Government Sales Tax. Act 117 also provides certain income tax reductions to address the regressive effect of the Sales Tax on taxpayers in lower income tax brackets. Act 117 repeals the 5% general excise tax imposed on imported goods and on goods manufactured in Puerto Rico. Certain items, such as fuel, crude oil and petroleum products, and vehicles, however, remain subject to the excise tax previously applicable to such items and will not be subject to the Sales Tax. The effective date of the repeal of the 5% general excise tax was October 17, 2006 pursuant to Act 229.

The Sales Tax will be effective on November 15, 2006. Municipalities, however, were authorized to implement the Municipal Sales Tax starting on July 1, 2006, and some have already done so. The revenues derived from the Sales Tax will be distributed as follows: (i) municipal governments will retain 1.3% of the Sales Tax, (ii) the Financial Assistance Fund, created by Act No. 91 of May 13, 2006, will receive 1% of the Sales Tax, and (iii) the General Fund will receive 4.7% of the Sales Tax. The revenues to be generated by the Sales Tax will be partly offset by the partial elimination of the 5% general excise tax and the effect of the income tax reduction measures included in Act 117.

Act 117 also provides for special income tax rates with respect to certain transactions occurring on and between July 1, 2006 and December 31, 2006. These special tax rates will apply to eligible dividends declared by domestic corporations or partnerships and “built-in” gains associated with capital assets held for periods in excess of six months, as well as certain withdrawals from retirement accounts. These special tax rates are only available for transactions in connection with capital assets consisting of stock or participations of domestic and foreign corporations and partnerships, and real property located in Puerto Rico. In the case of resident corporations and partnerships, these special tax rates apply only to real property located in Puerto Rico.

The Additional Lottery System (electronic Lotto Games) activities show a deficit of approximately \$170 million, mostly attributed to a payment amounting to \$200 million made in the prior year to the Commonwealth. This transaction was authorized pursuant to Law No. 171, dated July 29, 2004, which among other things authorizes the Secretary of the Treasury of the Commonwealth to provide funding for the payment of Lotto prize annuities upon depletion of other resources available at the Additional Lottery.

It is the opinion of the Additional Lottery Management that the deficiency is not an indication of financial difficulties for the payment of long-term Lotto prizes because funds will always be provided from either the Additional Lottery or from financial assistance from the Commonwealth.

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### (4) Changes in Reporting Entity and Restatement

The following table illustrates the change to net assets at the beginning of the year as previously reported in the governmental activities' statement of net assets and to fund balances at the beginning of the year as reported in the statement of revenue, expenditures, and changes in fund balances – governmental funds. The changes resulted from the effect of a correction of housing units and land lot held for resale, cash accounts not recorded in prior years, and to correct miscellaneous accounts resulting in a net effect of \$67.8 million. In addition, capital assets were decreased by \$22.9 million. The beginning balances have been restated as follows (expressed in thousands):

	<u>Net assets – governmental activities</u>	<u>Fund balances – general fund</u>
Beginning balance, as previously reported	\$ (15,916,789)	(511,271)
Correction of errors	7,134	7,134
Over capitalization of capital assets	(22,919)	—
Beginning balance, as restated	<u>\$ (15,932,574)</u>	<u>(504,137)</u>

The following table summarizes changes to net assets at the beginning of the year as previously reported in the statement of net assets by certain discretely presented component units. The changes resulted primarily from exclusions of nonmajor component units in the current year's presentation, and restatements to correct errors in the prior year's financial statements of certain component units (expressed in thousands):

Beginning net assets, as previously reported	\$ 17,763,736
Restatement of major component units:	
Puerto Rico Highways and Transportation Authority	(4,027,913)
Puerto Rico Infrastructure Financing Authority	1,394
Restatements of non-major component units	(8,954)
Non-major component units excluded in fiscal year 2005, but included in fiscal year 2006	11,526
Non-major component units included in fiscal year 2005, but excluded in fiscal year 2006	(27,075)
Beginning net assets, as restated	<u>\$ 13,712,714</u>

The Puerto Rico Highways and Transportation Authority has restated its financial statements principally for projects included as construction in progress that had also been included as roads, bridges, and for certain other projects for which capitalized interest has been overstated. The net effect of the restatement was to decrease capital assets and beginning balance of net assets by approximately \$4 billion.

### (5) Puerto Rico Government Investment Trust Fund (PRGITF)

PRGITF was created by Act No. 176, of August 11, 1995, and began operations on December 4, 1995. PRGITF is a no-load diversified collective investment trust administered by GDB that was created for the purpose of providing eligible governmental investors of Puerto Rico with a convenient and economical

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way to invest in a professionally managed money market portfolio. PRGITF is not an investment company or a mutual fund and is not subject to regulation or registration under the investment company Act of 1940. Units issued by PRGITF are not subject to regulation or registration under the Securities and Exchange Act of 1933, as amended, because the units are issued by a government entity. The deposits on hand and the investments purchased are not collateralized, secured, or guaranteed by the Commonwealth or any of its agencies, instrumentalities, or political subdivisions.

PRGITF is considered a 2a7-like external investment pool, and as such, reports its investment at amortized cost.

The investment securities on hand at June 30, 2006, consisted of certificates of deposit, bank notes, corporate obligations, commercial paper, and U.S. government and agencies obligations, all of which may be considered highly liquid. However, the participants' investments are subject to the ability of PRGITF to receive payment from the securities' issuer when due. The liquidity of certain investments and changes in interest rates may affect PRGITF's yield and the fair value of its investments.

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The dollar amount of the deposits on hand at June 30, 2006, at \$1.00 per unit of participation, was reported in the individual financial statements of each of the participants, and combined in the basic financial statements as follows (expressed in thousands):

	<u>Balance outstanding</u>	<u>Percentage of total</u>
Primary government:		
Commonwealth	\$ 231,207	66.80%
The Children's Trust	73,648	21.28%
Public Buildings Authority	78	0.02%
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	2	0.00%
Total for primary government	<u>304,935</u>	<u>88.10%</u>
Discretely presented component units:		
Puerto Rico Aqueduct and Sewer Authority	18,304	5.30%
Government Development Bank for Puerto Rico	16,157	4.67%
Institutional Trust of National Guard of Puerto Rico	3,510	1.01%
Puerto Rico Land Administration	611	0.18%
Puerto Rico Solid Waste Authority	560	0.16%
State Insurance Fund Corporation	413	0.12%
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	409	0.12%
Puerto Rico Electric Power Authority	155	0.04%
Puerto Rico Infrastructure Financing Authority	148	0.04%
Puerto Rico Highways and Transportation Authority	97	0.03%
National Parks Company of Puerto Rico	43	0.01%
Puerto Rico Convention Center District Authority	5	0.00%
	<u>40,412</u>	<u>11.68%</u>
Other governmental entities	<u>776</u>	<u>0.22%</u>
Total for all participants	<u>\$ 346,123</u>	<u>100.00%</u>

The deposits at June 30, 2006 were invested in securities with a cost which approximates fair value, plus accrued interest, for approximately \$346 million. The external portion of PRGITF was not considered significant for separate reporting in the accompanying basic financial statements.

### (6) Deposits and Investments

Pursuant to the provisions of Act No. 91 of March 29, 2004 that superseded Act No. 218 of 1951, as amended, the primary government may invest in different types of securities, including domestic, international, and fixed income securities, among others.

The primary government maintains a cash and investment pool that is available for use by all funds, except for the fiduciary funds. Each fund's portion of this pool is reported on the statement of net assets as cash

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and cash equivalents. The fiduciary funds investments are held and managed separately from those of other primary government funds.

### *Primary Government*

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

The carrying amount of deposits of the primary government at June 30, 2006 consists of the following (expressed in thousands):

	Carrying amount			Bank balance
	Unrestricted	Restricted	Total	
Commercial banks and U.S.				
Treasury	\$ 609,247	692,637	1,301,884	870,144
Component unit banks	1,783,040	1,896,060	3,679,100	2,775,618
Total	\$ 2,392,287	2,588,697	4,980,984	3,645,762

Custodial credit risk is the risk that in the event of bank failure, the primary government's deposit might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

At year-end, the Commonwealth's bank balance of deposits in commercial banks amounting to \$337 million was covered by Federal depository insurance or by collateral held by the Commonwealth's agent in the Commonwealth's name. Deposits of approximately \$533 million with the U.S. Treasury represent unemployment insurance taxes collected from employers that are transferred to the Federal Unemployment Insurance Trust Fund in the U.S. Treasury. These deposits are uninsured and uncollateralized. The bank balance of deposits in component unit banks, which as of June 30, 2006 amounted to approximately \$2.8 billion, are also uninsured and uncollateralized. These deposits in component unit banks are maintained with GDB and EDB. Deposits maintained in GDB and EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of GDB's or EDB's failure, the Commonwealth may not be able to recover these deposits.

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Deposits in component unit banks represent the balance of interest and noninterest-bearing accounts in GDB and EDB. The deposit liability at GDB and EDB is substantially related to deposits from other component units and of the Commonwealth. The deposit liability does not agree with the governmental cash balances shown above because of reconciling items such as outstanding checks and deposits in transit. The bank balance of GDB's and EDB's deposits at June 30, 2006 is broken down as follows (expressed in thousands):

Primary government	\$ 2,698,709
Discretely presented components units	<u>1,901,906</u>
Total pertaining to the Commonwealth	4,600,615
Municipalities of Puerto Rico	526,905
Other nongovernmental entities	790,517
Certificates of indebtedness	54,884
Escrow accounts	<u>153,487</u>
Total deposits per GDB and EDB	<u>\$ 6,126,408</u>

Unrestricted deposits include approximately \$231 million that are invested in PRGITF (see note 5). Such amount has been included as cash and cash equivalents in the primary government's statement of net assets.

## Investments

### *Custodial Credit Risk*

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the transaction, the primary government may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2006, securities investments were registered in the name of the Commonwealth and were held in the possession of the Commonwealth's custodian bank.

### *Primary Government*

The fair value by investment type, credit quality ratings, and maturity of the unrestricted investments reported by the governmental activities at June 30, 2006 consist of the following (expressed in thousands):

	Fair market value	Investment rating		Investment Maturity less than 1 year
		AAA to A	Not rated	
Guaranteed investment contract	\$ 83,684	83,684	—	83,684
PRGITF	73,647	73,647	—	73,647
Investment pool	30,769	30,769	—	30,769
Non participating contracts	<u>69</u>	<u>69</u>	<u>—</u>	<u>69</u>
Total investments	<u>\$ 188,169</u>	<u>188,169</u>	<u>—</u>	<u>188,169</u>

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### *Business-type Activities*

The fair value by investment type, credit quality ratings, and maturity of the restricted investments reported by the business-type activities at June 30, 2006 consist of the following (expressed in thousands):

	Fair value		Investment rating		
	Restricted	Total	AAA to A	BBB+	Not rated
Mortgage-backed securities	\$ 5,132	5,132	1,676	—	3,456
U.S. government and agency securities	8,044	8,044	8,044	—	—
U.S. equity securities	12,199	12,199	12,199	—	—
U.S. corporate debt securities	5,216	5,216	4,527	689	—
Other	2,882	2,882	2,882	—	—
Total	\$ 33,473	33,473	29,328	689	3,456

	Fair value	Maturity (in years)		
		Less than 1 year	1 to 5 years	6 to 10 years
Mortgage-backed securities	\$ 5,132	—	—	5,132
U.S. government and agency securities	8,044	—	6,797	1,247
U.S. equity securities	12,199	12,199	—	—
U.S. corporate debt securities	5,216	—	—	5,216
Other	2,882	1,697	1,185	—
Total	\$ 33,473	13,896	7,982	5,216

### *Component Units*

Cash, cash equivalents, and investments of the component units at June 30, 2006 consist of (expressed in thousands):

	Carrying amount			Bank balance
	Unrestricted	Restricted	Total	
Commercial banks	\$ 2,788,852	828,368	3,617,220	3,653,669
Component units banks	635,650	797,044	1,432,694	1,481,361
Total	\$ 3,424,502	1,625,412	5,049,914	5,135,030

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

Custodial credit risk is the risk that in the event of bank failure, the component unit's deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.



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Deposits maintained in GDB and EDB are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of GDB's or EDB's failure, the Commonwealth may not be able to recover the deposits.

The component units were exposed to the following custodial credit risk arising from the balance of deposits maintained in commercial and component unit banks at June 30, 2006 (expressed in thousands):

Uninsured and uncollateralized	\$	4,176,000
Uninsured and collateralized, with securities held by the pledging financial institutions		957,071
Uninsured and collateralized, with securities held by the pledging financial institutions		<u>1,959</u>
Total	\$	<u><u>5,135,030</u></u>

### *Investments*

The component units' investment policies allow management to purchase or enter into the following investment instruments:

- U.S. government and agencies obligations
- Certificates and time deposits
- Bankers' acceptances
- Obligations of the Commonwealth of Puerto Rico and municipalities
- Federal funds sold
- Securities purchased under agreements to resell
- World Bank securities
- Corporate debt, including investment contracts
- External investment pools
- Stock of corporations created under the laws of the United States of America or the Commonwealth
- Options, futures, and interest-rates swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products that qualify under any of the foregoing investment categories.
- Open-end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or AAA by Moody's Investors Service
- A few component units, principally SIFC, are also allowed to enter into foreign currency investments, under certain limitations

The component units' investment policies establish limitations and other guidelines on amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by



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country. In addition, such policies provide guidelines on the institutions with which investment transactions can be entered into.

The component unit's investment policies provide that investments transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by the Standard & Poor's or equivalent rating by Fitch or Moody's Investors Service, depending on the type and maturity of the investment and the counterparty to the transaction. Also, the investment policy specifies that no more than 5% of a manager's assets at fair value shall be invested in the securities of any single issuer.

All investments in U.S. treasury securities and mortgage-backed securities guaranteed by GNMA carry the explicit guarantee of the U.S. government and are presented as "not rated" in the table below. The credit qualifying rating for investments held by the component units at June 30, 2006 are as follows (expressed in thousands):

	Fair value			Investing rating		
	Unrestricted	Restricted	Total	Rating AAA to A	BBB+	Not rated
Mortgage-backed securities	\$ 593,693	985,805	1,579,498	1,573,483	—	6,015
U.S. government and agency securities	711,972	2,466,220	3,178,192	3,177,905	205	82
Negotiable certificates of deposit	306,075	261,148	567,223	438,825	—	128,398
U.S. corporate stocks	79,196	16,790	95,986	16,790	—	79,196
Non-U.S. corporate stocks	22,652	1,850	24,502	—	—	24,502
U.S. corporate bonds	487,681	15,950	503,631	357,340	145,992	299
Commercial paper	—	5,986	5,986	5,986	—	—
Repurchase agreement	16,185	—	16,185	16,185	—	—
Foreign and municipal bonds	9,674	1,521,251	1,530,925	6,753	1,523,473	699
Money market fund	157,804	30,726	188,530	30,726	—	157,804
Guaranteed investment contract	239,587	1,208,172	1,447,759	1,392,228	—	55,531
P.R. government investment trust fund	17,535	—	17,535	17,126	—	409
Investment pool	583,314	20,614	603,928	577,834	—	26,094
Security lending transactions	161,705	—	161,705	—	—	161,705
Investment in other equity securities	404,136	—	404,136	—	—	404,136
Non-participating contracts	79,232	44,479	123,711	—	—	123,711
Other	74,134	52,709	126,843	9,189	49,890	67,764
Total investments	\$ 3,944,575	6,631,700	10,576,275	7,620,370	1,719,560	1,236,345

Certain component units classified approximately \$23 million of investments presented in PRGITF as cash and cash equivalents.

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The following table summarizes the type and maturities of investments held by the component units at June 30, 2006 (expressed in thousands):

	Fair value	Maturity (in years)				
		Less than 1 year	1-5 years	6-10 years	More than 10 years	No stated maturity date
Mortgage-backed securities	\$ 1,579,498	36,605	59,183	24,520	1,459,190	—
U.S. government and agency securities	3,178,192	332,981	920,042	375,018	1,550,103	48
Negotiable certificates of deposit	567,223	315,378	2,428	—	249,417	—
U.S. equity securities	95,986	—	—	—	—	95,986
Non-U.S. equity securities	24,502	—	—	—	1,850	22,652
U.S. corporate debts securities	503,631	78,059	267,626	87,184	70,762	—
Commercial paper	5,986	5,986	—	—	—	—
Repurchase agreement	130,316	130,316	—	—	—	—
Foreign and municipal bonds	1,530,925	102,118	375,169	454,771	598,867	—
Money market fund	188,530	157,804	—	—	—	30,726
Guaranteed investment contract	1,447,759	261,354	301,554	—	884,851	—
PRGITF	17,535	17,122	—	—	—	413
Investment pool	603,928	577,834	—	—	—	26,094
Security lending transactions	47,574	27,569	13,205	6,800	—	—
Investment in other equity securities	404,136	352,123	—	—	800	51,213
Non-participating contracts	123,711	99,773	—	—	23,938	—
Other	126,843	3,996	63,944	—	—	58,903
Total investments	\$ 10,576,275	2,499,018	2,003,151	948,293	4,839,778	286,035

The component units were exposed to the following custodial credit risk for investments held at June 30, 2006 (expressed in thousands):

Insured or registered	\$ 2,385,461
Uninsured and registered, with securities held by the counterparty's trust department or agent in the component units' name	8,013,984
Uninsured and unregistered, with securities held by the counterparty's trust department or agent, but not in the component units' name	176,830
Total	\$ 10,576,275

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### Foreign Currency Risk

SIFC limits its exposure to foreign currency risk by limiting the total amount invested to 5% of the portfolio. The SIFC investments were presented as follow (in thousands):

Investment type	Local currency	Fair value
Money market funds	Canadian Dollar	\$ 1
	Euro	55
	Japanese Yen	57
		<u>\$ 113</u>
Common stocks	Australian Dollar	\$ 995
	British Pound	14,930
	Canadian Dollar	995
	Danish Krone	974
	Euro	16,739
	Hong Kong Dollar	1,351
	Japanese Yen	12,905
	Norwegian Krone	1,051
	Swedish Krone	823
	Swiss Franc	6,379
		<u>\$ 57,142</u>

Unrestricted repurchase agreements of approximately \$16 million belongs to EDB. As of June 30, 2006, the fair value of the collateral for the repurchase agreements amounted to approximately \$16 million for EDB, which consisted primarily of investment securities held in custody by EDB's agent.

### Fiduciary Funds

Cash and cash equivalents of the fiduciary funds at June 30, 2006 consist of the following (expressed in thousands):

	Carrying amount			Bank balance
	Unrestricted	Restricted	Total	
Commercial banks	\$ 666,159	1,717	667,876	670,331
Governmental banks	75,935	2,156	78,091	23,031
Total	<u>\$ 742,094</u>	<u>3,873</u>	<u>745,967</u>	<u>693,362</u>

Cash and cash equivalents consist of demand deposits, interest-bearing accounts, certificates of deposit, and bank investment contracts.

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### *Custodial Risk*

Custodial credit risk is the risk that, in the event of a bank failure, the fiduciary funds' deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth. There is no formal policy for custodial credit risk for cash accounts opened with commercial banks outside of Puerto Rico.

Deposits maintained in component unit banks are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk because in the event of the component unit bank's failure, the Commonwealth may not be able to recover these deposits.

As of June 30, 2006, \$47.2 million was exposed to custodial credit risk. Cash exposed to foreign currency risk as of June 30, 2006 is as follows (expressed in thousands):

Investment type	Currency	Fair value at U.S. dollar currency
Foreign currency	South African Rand	\$ 719
Foreign currency	Japanese Yen	312
Foreign currency	Swiss Franc	27
Foreign currency	Singapore Dollar	18
Foreign currency	Australian Dollar	2
Foreign currency	New Turkish Lira	1
		<u>\$ 1,079</u>

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### Investments

The investment policies of the pension trust funds limit the investment in corporate debt securities to the top rating issued by nationally recognized credit rating organizations. The portfolio is expected to maintain a minimum weighted average credit quality of either "A" or better using either Standard and Poor's or Moody's credit ratings. The following table summarizes the fair value by investment type and maturities of investments held by the pension trust funds at June 30, 2006 (expressed in thousands):

Investments type	Less than 1 year	1-5 years	6-10 years	More than 10 years	No stated maturity date	Total
Non-U.S. securities and other investments	\$ —	—	—	—	989,438	989,438
U.S. equity securities	—	—	—	—	2,330,196	2,330,196
U.S. government and agencies securities	101,778	113,732	37,799	142,385	—	395,694
Mortgage-backed securities	—	—	—	7	—	7
Money market funds	—	—	—	—	5,961	5,961
Municipal bonds	100	—	—	—	—	100
U.S. corporate debt securities	4,016	59,154	94,160	85,099	1,435	243,864
Limited partnership/private equity	—	—	—	—	87,824	87,824
Investment in PRTA Holdings	—	—	—	—	495,318	495,318
Other	—	—	—	—	19,508	19,508
Total	\$ 105,894	172,886	131,959	227,491	3,929,680	4,567,910

Expected maturities will differ from contractual maturities, because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table summarizes the credit quality ratings for investments held by the pension trust funds at June 30, 2006 (expressed in thousands):

Investments type	Fair value	AAA to A	BBB+	Not rated
Non-U.S. equity securities	\$ 989,438	—	—	989,438
U.S. equity securities	2,330,196	—	—	2,330,196
U.S. government and agencies securities	395,694	387,444	536	7,714
Mortgage-backed securities	7	—	—	7
Money market funds	5,961	—	—	5,961
Municipal bonds	100	—	100	—
U.S. debt securities	243,864	120,794	120,344	2,726
Limited partnership/private equity	87,824	—	—	87,824
Investment in PRTA Holdings	495,318	—	—	495,318
Other	19,508	—	—	19,508
Total	\$ 4,567,910	508,238	120,980	3,938,692

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As of June 30, 2006 the investments of the pension trust funds were exposed to custodial credit risk as follows (expressed in thousands):

Uninsured or unregistered investments not held in the name of the Commonwealth, but held by the counterparty's trust department, or the counterparty's agent, but not held in the Commonwealth's name	\$ <u>16,801</u>
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At June 30, 2006, securities investments amounting to \$4,055,793 were registered in the name of the pension trust funds and were held in the possession of the pension's trust funds custodian banks. Additionally, securities investments amounting to \$495,318 were registered in the name of the ERS and held in its possession.

The investment in non-U.S. stocks is expected to achieve long-term, aggressive capital appreciation by investing in Core EAFE (Europe Australasia and the Far East) securities. The portfolio is expected to be broadly diversified with respect to exposures to countries, economic sectors, industries, and individual stock. No single issue is expected to exceed 5% (at market) of the portfolio.

Investments exposed to foreign currency risk as of June 30, 2006 are as follows (expressed in thousands):

Investment type	Currency	Fair value at U.S. dollar currency
Equity securities	Euro	\$ 270,033
Equity securities	Japanese Yen	246,779
Equity securities	Pound Sterling	223,110
Equity securities	Swiss Franc	66,699
Equity securities	Australian Dollar	38,397
Equity securities	Swedish Krona	30,358
Depository receipts	Commingled	24,246
Equity securities	Hong Kong Dollar	23,910
Mutual funds	Pound Sterling	17,726
Equity securities	New Zealand Dollar	10,020
Equity securities	Russia Rubles	8,858
Equity securities	Danish Krone	5,650
Equity securities	Canadian Dollar	5,570
Equity securities	Turkey Libra	4,429
Equity securities	Brazil Real	4,429
Equity securities	Mexico Pesos	4,286
Equity securities	Poland Zlotys	2,286
Equity securities	Thailand Baht	2,143
Equity securities	Singapore	366
Equity securities	South African	143
		\$ <u>989,438</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

### (7) Securities Lending Transactions

During the year, the pension trust funds, included within the fiduciary funds, and SIFC and AACA, two discretely presented component units, entered into securities lending transactions. These transactions are explained below:

#### Pension Trust Funds

The Retirements System participates in a security lending program whereby securities are transferred to an independent broker or dealer in exchange for collateral in the form of cash, government securities, and irrevocable bank letters of credit equal to approximately 102% of the market value of the domestic securities on loan and 105% of the market value of the international securities on loan, with a simultaneous agreement to return the collateral for the same securities in the future. Collateral is marked to market daily and the agent places a request for additional collateral from brokers if needed. The custodian bank is the agent for the securities lending program.

Securities lending obligations for which collateral was received as of June 30, 2006 consist of the following (expressed in thousands):

<b>Securities lent</b>	<b>FV of underlying securities</b>
U.S. corporate debt securities	\$ 19,672
U.S. government securities	61,925
U.S. equity securities	110,496
Non U.S. equity securities	49,819
	<u>\$ 241,912</u>



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

The collateral received amounted to approximately \$247.2 million. The collateral securities cannot be pledged or sold unless the borrower defaults; therefore, these transactions are not reported as assets and liabilities in the statements of fiduciary net assets. Collateral received was invested as follows:

<b>Collateral</b>	<b>Fair value</b>
Commercial paper	\$ 72,105
Certificate of deposit	47,129
Corporate	38,023
Bank note	17,506
TD	14,329
Repo	12,107
ABCP	7,331
CP	3,115
Deposit note	42
Reverse repurchase agreement U.S. agency delivered	5,541
Reverse repurchase agreement U.S. mortgage-backed tri-party	30,000
	<u>\$ 247,228</u>

The relationship between the investment maturities and the Retirement Systems' loans cannot be determined.

At year-end, the Retirement Systems have no credit risk exposure to borrowers because the amounts that the Retirement Systems owe the borrowers exceed the amounts the borrowers owe to the Retirement Systems. The Retirement Systems' rights to collateral are defined in the contractual agreements. The borrower's creditworthiness is also proactively reviewed by the lending agent.

### *Component Units*

#### **SIFC**

The Commonwealth statutes and the SIFC's board of directors' policies permit SIFC to use its investments to enter into securities lending transactions. The SIFC's securities custodian, as agent of SIFC, manages the securities lending program and receives cash, securities, or irrevocable bank letters of credit as collateral. The collateral securities cannot be pledged or sold by SIFC unless the borrower defaults. The collateral requirement is equal to 102% for securities issued in the United States and 105% for securities issued outside of the United States of the fair value of the securities lent. Additional collateral has to be provided by the next business day if its value falls to less than 100% of the fair value of the securities lent. At year-end, SIFC has no credit risk exposure to borrowers because the amounts SIFC owes the borrowers exceed the amounts the borrowers owe SIFC. Contracts with the lending agents require them to indemnify SIFC if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay SIFC for income distributions by the securities' issuers while the securities are on loan.

All security loans can be terminated on demand by either SIFC or the borrower, although the average term of the loans is two weeks. In lending securities, the term to maturity of the securities loans is matched with the term to maturity of the investment of the cash collateral. Such matching existed at year-end. Securities

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

lending obligations for which cash was received as collateral as of June 30, 2006 consist of the following (expressed in thousands):

<b>Securities lent</b>	<b>Fair value of underlying securities</b>
Equity securities	\$ 58,300
U.S. government, agencies, instrumentalities obligations	47,986
U.S. corporate debt and notes	5,916
	<u>\$ 112,202</u>

Cash collateral received amounted to \$114 million and it was invested in repurchase agreements. These secured lending activities are included in the accompanying statement of net assets, since cash was received as collateral but reinvested as explained above.

In addition, SIFC had the following securities lending obligations collateralized by securities as of June 30, 2006 (expressed in thousands):

<b>Securities lent</b>	<b>Fair value of underlying securities</b>	<b>Securities collateral received</b>
U.S. government, agencies, instrumentalities obligations	\$ 37,630	40,067

These securities lending transactions are collateralized by securities that cannot be pledged or sold unless the borrower defaults; therefore, they are not reported as assets and liabilities in the accompanying balance sheets.

### AACA

AACA lends securities to broker/dealers and other entities (borrowers) for collateral that will be returned in the future for the same securities. The custodial bank manages the securities lending program and receives cash, government securities, and letters of credit as collateral. The program provides for an initial minimum collateralization of 102% of the market value of the securities lent plus accrued income. Additional collateral has to be provided by the close of the next business day if its value falls to less than 100%. The contract with the custodial bank requires that should a collateral deficiency occur beyond the custodian's responsibilities, the deficiency should be allocated pro rata among all client lenders within the program.

Either the custodian bank or the borrower can terminate all security loans at any time. Cash collateral is invested in the program's agent short-term investment pools, which at fiscal year-end had a weighted average maturity of approximately 30 days. The relationship between securities of the investment pool and AACA loans cannot be determined.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

The following represents the balances relating to the securities lending transactions as of June 30, 2006 (expressed in thousands):

<b>Securities lent</b>	<b>Fair value of underlying securities</b>	<b>Cash collateral received</b>	<b>Noncash collateral received</b>
U.S. Treasury bills, bonds, and notes	\$ 17,700	15,832	2,161
Common stocks and preferred stocks	20,882	20,790	476
Corporate bonds	2,844	2,603	292
U.S. agencies	8,206	8,349	1
<b>Totals</b>	<b>\$ 49,632</b>	<b>47,574</b>	<b>2,930</b>

Secured lending transactions where cash collateral was received and reinvested are presented as assets and liabilities in the accompanying statement of net assets. Securities lending transactions collateralized by noncash collateral that cannot be pledged or sold unless the borrower defaults are not reported as assets and liabilities in the statement of net assets. At year-end, AACA has no credit risk exposure to borrowers because the amounts AACA owes the borrowers exceed the amounts the borrowers owe AACA.

### (8) Investments in Limited Partnerships

Pursuant to the Statement of Investment Guidelines for the Government of Puerto Rico, the pension trust funds and a component unit invested approximately \$7.3 million in limited partnerships during the fiscal year ended June 30, 2006. The investments were as follows:

- During fiscal year 2006, there were no contributions to Guayacán Funds of Funds, L.P., a Delaware limited partnership, organized by Grupo Guayacán, Inc. as general partner, that has total commitments of \$55.5 million (of which \$45 million are from pension trust funds and the remaining balance from the private corporate investors). This fund invests in United States and international private equity partnerships that in turn invest in private companies.
- During fiscal year 2006, there were no contributions to Guayacán Fund of Funds II, L.P., a Delaware limited partnership, organized by Grupo Guayacán, Inc. as general partner, that has total commitments of \$62 million (of which \$50 million are from the pension trust funds and the remaining balance from the private corporate investors in Puerto Rico). This fund invests in a broad range of United States and international private equity investment partnerships that, in turn, will make equity and equity-related investments primarily in private businesses.
- During the fiscal year 2006, \$3.1 million was invested in Guayacán Private Equity Fund, L.P., a Delaware limited partnership, organized by Advent/Morro Partners as general partner, that has total commitments of \$42 million (of which \$10 million is from the pension trust funds, \$22.5 million are from a component unit, and the remaining balance from the private corporate investors in Puerto Rico). This fund invests in Puerto Rico private equity.
- During the fiscal year 2006, \$752,000 was invested in Invesco Venture Partnership Fund III, L.P. a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as general partner in which the pension trust funds have a total commitment of \$5.5 million. The Partnership was

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

organized to invest in other collective investment funds investing in alternative assets, including primarily United States and international funds that focus on both early- and later-stage venture capital investments.

- During the fiscal year 2006, \$677,000 was invested in Invesco Non- U.S. Partnership Fund III, L.P. a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as general partner, in which the pension trust funds have a total commitment of \$4.5 million. The Partnership was organized to invest in other collective investment funds investing in alternative assets, including primarily investments focusing on non-U.S. buyouts, expansion capital, turnaround, mezzanine, and distressed investment partnership.
- During the fiscal year 2006, \$910,000 was invested in Invesco U.S. Buyout & Expansion Capital Partnership Fund III, L.P., a Delaware limited partnership, organized by IPC Partnership Associates III, LLC as General Partner in which the pension trust funds have a total commitment of \$3.7 million. The Partnership was organized to invest in other collective funds investing in alternative assets, including primarily investments focusing on small, mid-size, and large domestic buyout transactions.
- During the fiscal year 2006, \$1,900,000 was invested in Chase Capital Partners Private Equity Fund of Funds II, LTD, a limited partnership, organized by Chase as general partner in which the pension trust funds have a total commitment of \$35 million. The fund's investment strategy is to capitalize on a globally diversified portfolio of private equity investments opportunities across various sectors, including buyouts, growth equity, venture capital, and other special situations through partnership, investments, and direct investments.

The fair value of these investments at June 30, 2006 amounted to \$87.8 million and is presented within investments in the statement of net assets. The fair values of these investments have been estimated by the corresponding general partner or fund manager of these partnerships and disclosed in its respective separate audited financial statement. The allocations of net gain and net loss to the limited partners are based on certain percentages, as established in the limited partnership agreements. The difference between the fair value of the investments and the total cumulative contributions is mostly due to distributions made.

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2006

As of June 30, 2006, the pension trust funds and a discretely presented component unit had capital commitments and contributions as follows (expressed in thousands):

	<u>Public sector commitments</u>	<u>Fiscal year contributions</u>	<u>Cumulative contributions</u>
<b>Guayacán Funds of Funds, L.P.</b>			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	\$ 25,000	—	23,279
Puerto Rico System of Annuities and Pensions for Teachers	20,000	—	18,623
Subtotal	45,000	—	41,902
<b>Guayacán Fund of Funds II, L.P.</b>			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	25,000	—	19,639
Puerto Rico System of Annuities and Pensions for Teachers	25,000	—	19,639
Subtotal	50,000	—	39,278
<b>Guayacán Private Equity Fund, L.P.</b>			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	5,000	477	4,407
Puerto Rico System of Annuities and Pensions for Teachers	5,000	477	4,407
Component unit:			
Governmental Development Bank	20,000	1,907	17,624
UPR Employees' Retirement System	2,500	238	2,203
Subtotal	32,500	3,099	28,641
<b>Other Funds</b>			
Primary government:			
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	22,596	1,266	18,903
Puerto Rico System of Annuities and Pensions for Teachers	28,714	2,972	23,547
Subtotal	51,310	4,238	42,450
Total	\$ 178,810	7,337	152,271

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

Public sector commitments represent the overall commitment established since the first day the pension trust funds began investing in the limited partnerships. Cumulative contributions represent the total contributions made through December 31, 2006, without considering distributions already made by the limited partnerships since its inception.

#### (9) Receivables and Payables

Receivables in the governmental funds include approximately \$1.2 billion of accrued income and excise taxes and \$300 million receivable from the federal government and \$17 million from the Municipal Revenue Collection Center. In addition, the enterprise funds include \$65 million of unemployment, disability, and drivers' insurance premium receivable.

Payables in the governmental funds include approximately \$580 million of trade accounts due to suppliers for purchase of merchandise and services rendered and \$264 million of tax refunds liability. Also at June 30, 2006, excess of checks drawn over the pooled bank balance amounted to approximately \$1.4 billion and is reported within accounts payable and accrued liabilities of the governmental activities.

In accordance with GASB Technical Bulletin No. 2004-1, Tobacco Settlement Recognition and Financial Reporting Entity Issue (the TB), a receivable of \$36 million was recorded in the government-wide financial statements for estimated shipments from January 1 to June 30, 2006, which will be applied to debt service upon collection. Additionally, the TB indicated that the Children's Trust (the Trust) designated as the Tobacco Settlement Authority (TSA) should recognize a liability for the bonds payable and an expense (and liability if unpaid) in the same period in its stand-alone financial statements. The expense (and liability if unpaid) recognizes the contractual obligation to remit the proceeds of the bond sold. Since the Trust is reported as a blended component unit, the TB indicates these remittances should be reported as transfers into the fund receiving the proceeds and transfers out in the fund that accounts for the activities of the TSA. Since the Trust has no contractual obligation, under its enabling legislation or elsewhere, to remit all bond proceeds or assets related to the global settlement agreement (GSA) to the settling government (the Commonwealth), the Trust has not recognized an expense and liability for unpaid proceeds from the bonds since it records the expense as amounts are disbursed as grants to its settling government (including its instrumentalities) or third parties.

#### (10) Interfund and Intraentity Transactions

Interfund receivables and payables at June 30, 2006 are summarized as follows (expressed in thousands):

Receivable fund	Payable fund	Amount
Nonmajor governmental fund	General fund	\$ 156,142
General fund	Nonmajor governmental fund	373,385
Unemployment insurance	General fund	23,010
Lotteries	General fund	53,174
General fund	Lotteries	59,654
		\$ 665,365

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Transfers from/to other funds for the year ended June 30, 2006 are summarized as follows (expressed in thousands):

<u>Transferee fund</u>	<u>Transferor fund</u>	<u>Amount</u>
General	Nonmajor governmental	\$ 7,259
General	The Children's Trust special revenue	26,688
Nonmajor governmental	General	293,440
Unemployment	General	204,330
General	Unemployment	268,790
Debt service	General	484,368
General	Debt service	100,000
General	Lotteries	204,302
Lotteries	General	21,318
Nonmajor enterprise	General	4,802
The Children's Trust special revenue	General	391
PBA capital projects	General	38,002
		<u>\$ 1,653,690</u>

The principal purposes of the interfund transfers are to (amounts expressed in thousands):

1. Distribute the increase in net assets of the lotteries fund for the use of the general fund, as required by the lotteries enabling legislation (\$204,302).
2. Make funds available for debt service payments in the debt service fund and the general fund (\$484,368).
3. Reimburse from the debt service fund for a portion of the fiscal year 2006 debt service financed by the general fund.
4. Unemployment insurance trust fund's distribution of surplus cash belonging to the general fund for the payment of administrative expenses (\$268,790).
5. Recognize as transfers the rental payments made by the Commonwealth's agencies on properties leased by PBA, a blended component unit of the Commonwealth (\$293,440 to the nonmajor funds of PBA and \$38,002 to the PBA capital project fund).
6. Transfer from the general fund to the Additional Lottery to cover prizes settlement pursuant Act No. 171 of July 24, 2004 (\$21,318).
7. Transfer from the Children's Trust to the general fund in order to provide financial assistance to carry out project aimed at promoting the well-being of children and youth of Puerto Rico (\$26,688).



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

8. Transfer from capital project fund for repayment of general fund's lines of credit, pursuant to such line of credit agreement (\$7,259).
9. To provide local matching funds from the general fund related to the federal capital grants of the Puerto Rico Water Pollution Revolving Fund and Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, two enterprise funds of the Commonwealth (\$4,802).
10. Transfer of \$391 from the Tobacco Settlement Asset-Backed Bonds debt service fund to the Children's Trust special revenue fund in order to provide funds for operating expenses.

Interfund receivables and payables represent the pending settlements of the aforementioned transfers.

Due from/to primary government and component units are as follows (expressed in thousands):

Receivable entity/fund	Amount	Payable entity/fund	Amount
Business-type activities	\$ 188,055	Puerto Rico Aqueduct and Sewer Authority	\$ 188,055
		Cardiovascular Center Corporation of Puerto Rico and the Caribbean	42,186
		Puerto Rico Medical Services Administration	27,012
		Puerto Rico Health Insurance Administration	25,800
		Puerto Rico Tourism Company	17,993
		Employment & Training Enterprises Corporation	7,108
Governmental activities	125,395	Governing Board of the 911 Service	5,296
	<u>\$ 313,450</u>		<u>\$ 313,450</u>
Puerto Rico Electric Power Authority	\$ 170,362	Governmental activities	\$ 372,902
University of Puerto Rico	106,134		
Puerto Rico Conservatory of Music	23,908		
Puerto Rico Health Insurance Administration	23,857		
Puerto Rico Industrial Development Company	23,403		
Puerto Rico Medical Services Administration	19,937		
Land Authority of Puerto Rico	5,301		
	<u>\$ 372,902</u>		<u>\$ 372,902</u>

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

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The amount owed by PRASA of \$188 million represents construction loans granted by the Puerto Rico Water Pollution Control Revolving Fund and the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, nonmajor enterprise funds, to finance the construction of capital assets for PRASA.

The amount receivable by PREPA from the primary government includes approximately \$43 million representing an agreement with the Commonwealth by which the Commonwealth will pay the outstanding fuel adjustment subsidy and certain other accumulated debt. The amount owed by the Commonwealth is presented within notes payable in the statement of net assets of the governmental activities.

The amount receivable by the UPR from the primary government includes a resolution approved by the Legislature of the Commonwealth to pay \$94.7 million to the UPR on behalf of the Department of Health of the Commonwealth over eight years, including the financing of additional debts of approximately \$71.2 million. The related outstanding balance of \$71.5 million is presented by the Commonwealth within notes payable in the statement of net assets of the governmental activities.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Due from/to component units are as follows (expressed in thousands):

Receivable entity/fund	Amount	Payable entity/fund	Amount
Puerto Rico Electric Power Authority	\$ 25,844	Puerto Rico Medical Services Administration	\$ 38,720
University of Puerto Rico	18,030	Cardiovascular Center Corporation of Puerto Rico and the Caribbean	5,154
State Insurance Fund Corporation	3,500	Puerto Rico Solid Waste Authority	3,500
Puerto Rico Land Administration	4,627	Puerto Rico Industrial Development Company	4,627
Farm Insurance Corporation of Puerto Rico	13,386	Agricultural Services and Development Administration	23,886
Land Authority of Puerto Rico	16,931	Farm Insurance Corporation of Puerto Rico	6,431
	<u>82,318</u>	Sub total	<u>82,318</u>
Governmental Development Bank for Puerto Rico	2,313,577	Puerto Rico Aqueduct and Sewer Authority	725,150
		Special Communities Perpetual Trust	425,107
		Puerto Rico Ports Authority	301,560
		Puerto Rico Electric Power Authority	172,667
		Puerto Rico Convention Center District Authority	154,846
		Agricultural Services and Development Administration	117,758
		University of Puerto Rico	96,645
		Puerto Rico Solid Waste Authority	84,333
		Puerto Rico Industrial Development Company	69,641
		Puerto Rico Infrastructure Financing Authority	45,014
		Puerto Rico Land Authority	41,444
		Puerto Rico Highways and Transportation Authority	29,996
		Puerto Rico Metropolitan Bus Authority	22,304
		Economic Development Bank for Puerto Rico	12,207
		National Parks Company of Puerto Rico	6,831
			<u>2,305,503</u>
	<u>\$ 2,395,895</u>		<u>\$ 2,387,821</u>

The difference amounting to \$8.1 million between due from/to component units resulted from the time lag between the dates that transactions are recorded by each discretely presented component unit and other reconciling items. The balance due to GDB amounting to approximately \$2.3 billion represents loans payable to GDB at June 30, 2006.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

The rest of the loans receivable reported by GDB consist of the following (expressed in thousands):

Primary government:	
Governmental activities	\$ 3,705,127
Pension trust funds	4
	<u>3,705,131</u>
Other governmental entities and municipalities	737,386
Private sector (net of \$11,748 presented within restricted assets)	<u>512,619</u>
Total loans receivable reported by GDB	<u><u>\$ 4,955,136</u></u>

The loans to the primary government are presented by the Commonwealth within notes payable in the statement of net assets and in the statement of fiduciary net assets.

Expenses of the primary government include approximately \$2.4 billion in capital and operational contributions made by the primary government to the component units, comprised of the following (expressed in thousands):

Puerto Rico Health Insurance Administration	\$ 1,134,152
University of Puerto Rico	812,594
Puerto Rico Infrastructure Financing Authority	72,450
Government Development Bank for Puerto Rico	65,316
Puerto Rico Aqueduct and Sewer Authority	19,096
Nonmajor component units	<u>323,553</u>
Total contributions made by primary government to component units	<u><u>\$ 2,427,161</u></u>

### (11) Restricted Assets

Restricted assets of the primary government included in the basic financial statements at June 30, 2006 consist of cash, investments, and other assets to be used for the following purposes (expressed in thousands):

Debt service and sinking fund	\$ 1,762,404
Public Housing Administration – funds received from HUD	596,390
Construction and betterment funds	47,155
Emergency fund	100,000
Assets held in trust for repayment of QZAB	39,618
Assets held for development of urban forest	19,200
Investment held for disability insurance benefits	33,473
Construction of governmental agencies	6,200
Residual receipts from sale of properties	<u>17,730</u>
	<u><u>\$ 2,622,170</u></u>

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2006

Liabilities of the primary government payable from restricted assets consist of the following (expressed in thousands):

Qualified Zone Academic Bonds	\$	184,124
Tax revenue anticipation notes		1,050,037
Deferred revenue		988,382
Interest payable		302,357
Liabilities payable from restricted assets – governmental activities	\$	<u>2,524,900</u>
Business-type activities:		
Disability insurance benefit payable	\$	<u>33,473</u>
Liabilities payable from restricted assets – business-type activities	\$	<u>33,473</u>
Governmental activities restricted net assets:		
Restricted for debt service	\$	192,490
Other purpose		87,588
Total restricted net assets	\$	<u>280,078</u>

Restricted assets of the component units included in the basic financial statements at June 30, 2006 are to be used for the following purposes (expressed in thousands):

Debts service and sinking fund requirements	\$	4,701,124
Construction and betterments funds		2,164,918
Escrow		597,126
Collateral for underlying securities		418,043
Incentives to farmers		183,286
Other uses		100,055
Industrial incentives		76,298
Malpractice insurance fund		65,654
Maintenance reserve fund		53,591
Educational fund		52,476
Total for components units	\$	<u>8,412,571</u>

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2006

**(12) Capital Assets**

Capital assets activity for the year ended June 30, 2006 is as follows (expressed in thousands):

***Primary Government***

	<b>Beginning balance (as restated)</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending balance</b>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 930,466	5,655	87,678	848,443
Construction in progress	1,254,123	450,371	322,671	1,381,823
Total capital assets, not being depreciated	2,184,589	456,026	410,349	2,230,266
Capital assets, being depreciated:				
Buildings and building improvements	6,492,175	292,454	189,327	6,595,302
Equipment	373,368	43,949	26,686	390,631
Infrastructure	417,336	24,164	—	441,500
Total capital assets, being depreciated	7,282,879	360,567	216,013	7,427,433
Less accumulated depreciation for:				
Buildings and building improvements	2,115,330	178,604	93,782	2,200,152
Equipment	180,654	35,602	25,838	190,418
Infrastructure	75,363	8,588	—	83,951
Total accumulated depreciation	2,371,347	222,794	119,620	2,474,521
Total capital assets, being depreciated, net	4,911,532	137,773	96,393	4,952,912
Governmental activities capital assets, net	\$ 7,096,121	593,799	506,742	7,183,178
Business-type activities:				
Total capital assets, being depreciated – equipment	\$ 5,014	29	—	5,043
Less accumulated depreciation of equipment	3,647	388	—	4,035
Total business-type activities capital assets, being depreciated, net	\$ 1,367	(359)	—	1,008

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Depreciation expense was charged to functions/programs of the primary government for the year ended June 30, 2006 as follows (expressed in thousands):

Governmental activities:

General government	\$	70,038
Public safety		21,573
Health		6,105
Public housing and welfare		81,512
Education		29,335
Economic development		14,231
Total depreciation expense – governmental activities	\$	<u>222,794</u>
Total depreciation business-type activities – lotteries	\$	<u>388</u>

The net book value of capital assets of the primary government as of beginning of the year was decreased by approximately \$22.9 million to correct prior years' understatement of depreciation.

The Commonwealth adopted the provision of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, an amendment to GASB Statement No. 34. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries. As a result of the adoption of this statement, the Commonwealth recognized an impairment loss of \$63 million in the statement of activities, related to the closing of educational, health, and correctional facilities (\$51 million) and idle projects due to lack of funding (\$12 million).

General infrastructure assets include \$417 million representing the estimated cost of assets transferred to the Department of Natural and Environmental Resources (DNER) of the Commonwealth in 1997 upon completion of the Cerrillos Dam and Reservoir and the Portugues-River and Bucana-River Projects by the U.S. Army Corps of Engineers. These infrastructure assets are reported within governmental activities and include dams, intake facilities, and similar items built for flood control, water supply, and recreational purposes. The Commonwealth also recorded a payable due to the U.S. Army Corps of Engineers, amounting to \$205 million, for its estimated allocated share of the construction costs associated with these projects, including accrued interest of \$5 million. The final debt agreement between DNER and the U.S. Army Corps of Engineers has not been finalized and therefore terms and conditions could differ from those estimated. The depreciation is computed using the straight-line method over an estimated useful life of 50 years from the transfer date of the property. The related debt is expected to be payable on an annual basis over a 50-year period. However, the debt has been presented as a long-term payable after one year in the accompanying statement of net assets since the commencement date of repayment has not yet been determined.

On August 17, 2001, the Legislature of the Commonwealth approved Act No. 120, which requires the conditional transfer of the ownership of certain real properties under the name of the Department of Recreation and Sports (DRS) of the Commonwealth to the municipalities of the Commonwealth. The land and the facilities were transferred at no cost to the municipalities. During fiscal year ended June 30, 2006, land, building, and building improvements with a total carrying amount of \$79 million, were transferred to several municipalities and recorded as an expense in the accompanying statement of activities.



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

### *Discretely Presented Component Units*

	Beginning balance (as restated)	Increases	Decreases	Ending balance
Capital assets, not being depreciated:				
Land	\$ 2,444,784	102,235	7,709	2,539,310
Art works	2,986	71	—	3,057
Construction in progress	5,533,365	1,849,082	1,150,602	6,231,845
Total capital assets, not being depreciated	7,981,135	1,951,388	1,158,311	8,774,212
Capital assets, being depreciated:				
Buildings and buildings improvements	8,474,986	474,624	97,892	8,851,718
Equipment	1,123,649	207,043	26,505	1,304,187
Infrastructure	22,065,174	513,229	1,649	22,576,754
Total capital assets, being depreciated	31,663,809	1,194,896	126,046	32,732,659
Less accumulated depreciation for:				
Buildings and buildings improvements	4,692,692	345,674	35,892	5,002,474
Equipment	680,724	100,678	19,949	761,453
Infrastructure	8,641,970	490,969	930	9,132,009
Total accumulated depreciation	14,015,386	937,321	56,771	14,895,936
Total capital assets, being depreciated, net	17,648,423	257,575	69,275	17,836,723
Capital assets, net	\$ 25,629,558	2,208,963	1,227,586	26,610,935

The principal restatement in the beginning balance of capital assets corresponds to Puerto Rico Highways and Transportation Authority's approximately \$4 billion correction for projects included as construction in progress that had already been included as infrastructure assets and for other projects with overcapitalized interest. The remaining \$89.1 million correcting reduction in the beginning balance of capital assets is related to the other component units sustaining restatements included in note 4.

### (13) Tax Revenue Anticipation Notes Payable

Tax revenue anticipation notes (TRANS) reported in the general fund were issued on December 29, 2005 at interest rates ranging from 3.79% to 4.5% and were paid on July 28, 2006. The TRANS amounted to \$1,050 million at June 30, 2006 plus accrued interest of approximately \$23 million. The proceeds of the TRANS were used to cover temporary cash deficiencies resulting from the timing differences between tax collections and the payments of current expenditures.

**COMMONWEALTH OF PUERTO RICO**

**Notes to Basic Financial Statements**

June 30, 2006

**(14) Short and Long-term Obligations**

**Primary Government**

**(a) Summary of Short and Long-term Obligations**

Short and long-term obligations at June 30, 2006 and changes for the fiscal year then ended are as follows (expressed in thousands):

	Balance at June 30, 2005	Debt issued	Capitalized interest	Debt paid	Original issue (discounts) premiums	Other net increases (decreases)	Balance at June 30, 2006	Due within one year
Governmental activities:								
General obligation and revenue bonds	\$ 12,247,121	101,695	30,409	(209,280)	(323)	25,461	12,195,083	253,559
Commonwealth appropriation bonds	2,715,239	—	1,516	(78,365)	—	3,804	2,642,194	84,190
Qualified Zone Academy Bonds	47,936	39,353	—	—	—	96,835	184,124	—
Notes payable to component units:								
GDB (short-term)	186,510	1,940,096	—	(1,600,562)	—	—	526,044	526,044
GDB	1,871,381	1,377,310	—	(39,608)	—	(30,000)	3,179,083	99,329
Other	136,548	—	—	(21,897)	—	—	114,651	—
Total bonds and notes payable	17,204,735	3,458,454	31,925	(1,949,712)	(323)	96,100	18,841,179	963,122
Compensated absences	1,451,320	—	—	(838,933)	—	1,071,566	1,683,953	962,323
Net pension obligation	4,479,795	—	—	—	—	261,011	4,740,806	—
Obligation under capital lease arrangements	146,676	4,580	—	(6,755)	—	—	144,501	4,476
Other liabilities:								
Employees' Christmas bonus	167,533	—	—	(287,199)	—	222,228	102,562	102,562
Liability for federal cost disallowances	123,368	—	—	(2,867)	—	(67,454)	53,047	—
Liability for legal claims and judgments	941,283	—	—	(43,451)	—	(96,665)	801,167	43,400
Other	150,940	—	—	—	—	54,060	205,000	—
Total governmental activities	24,665,650	3,463,034	31,925	(3,128,917)	(323)	1,540,846	26,572,215	2,075,883
Business-type activities:								
Notes payable to component units	520	—	—	(520)	—	—	—	—
Compensated absences	6,842	—	—	(3,468)	—	3,991	7,365	3,857
Obligation for unpaid lottery prizes	329,108	—	—	—	—	(25,405)	303,703	37,488
Claims liability for insurance benefits	71,028	211,370	—	(211,425)	—	—	70,973	70,973
Total business-type activities	407,498	211,370	—	(215,413)	—	(21,414)	382,041	112,318
Total governmental and business-type	\$ 25,073,148	3,674,404	31,925	(3,344,330)	(323)	1,519,432	26,954,256	2,188,201

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

The balances of long-term debt issued included with other financing sources and debt service principal expenditures as reported in the statement of revenue, expenditures, and changes in fund balances – governmental funds do not agree with amounts reported as debt issued and paid in the above table primarily because the above table includes debt issued and paid on short-term obligations which amounted to approximately \$1.9 billion and \$1.6 billion, respectively. The receipt and payment of short-term obligations is reported as a balance sheet transaction in the fund financial statements.

The other net increases in bonds and notes payable consist of deferred losses on refunding, net of amortization, and net amortization of premiums and discounts on bonds. These adjustments did not require any source or use of cash.

Compensated absences, net pension obligation, obligation for unpaid lottery awards, liability for insurance benefits, and other long-term liabilities reflect other net increases (decreases) resulting from adjustments and changes to agree these obligations to their new estimated balances at June 30, 2006.

#### **(b) Debt Limitation**

The Constitution of the Commonwealth authorizes the contracting of debts as determined by the Legislature. Nevertheless, the Constitution of the Commonwealth provides that direct obligations of the Commonwealth evidenced by bonds or notes and backed by the full faith, credit, and taxing power of the Commonwealth are not to be issued if the amounts of the principal of, and interest on, such bonds and notes and on all such bonds and notes issued thereafter, which are payable in any fiscal year, together with any amount paid by the Commonwealth in the preceding fiscal year on account of bonds or notes guaranteed by the Commonwealth, exceeds 15% of the average annual revenue raised under the provisions of Commonwealth legislation and conveyed into the Treasury (hereinafter internal revenue) in the two fiscal years preceding the then current fiscal year. Section 2, Article VI of the Constitution does not limit the amount of debt that the Commonwealth may guarantee so long as the 15% limitation is not exceeded. Internal revenue consists principally of income taxes and excise taxes. Certain revenue, such as federal excise taxes on offshore shipments of alcoholic beverages, tobacco products, and customs duties, which are collected by the U.S. government and returned to the Commonwealth, and motor vehicle fuel taxes and license fees, which are allocated to the PRHTA, a discrete component unit, are not included as revenue for the purpose of calculating the debt limit, although they may be available for the payment of debt service. At June 30, 2006, the Commonwealth is in compliance with the debt limitation requirement.

#### **(c) Bonds Payable**

The Constitution of the Commonwealth provides that public debt will constitute a first claim on the available revenue of the Commonwealth. Public debt includes general obligations and notes of the Commonwealth and any payment required to be made by the Commonwealth under its guarantees of bonds issued by blended or discretely presented component units. The good faith, credit, and taxing power of the Commonwealth are irrevocably pledged for the prompt payment of the principal and interest of the general obligation bonds.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Act No. 83 of August 30, 1991, as amended, provides for the levy of an annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation. The levy is made by CRIM, a municipal corporation, not a component unit of the Commonwealth. CRIM is required to remit the 1.03% of property tax collected to the Commonwealth to be used by the Commonwealth's debt service fund for payment of debt service on general obligations of the Commonwealth. During the year ended June 30, 2006, the total revenue and receivable reported by the Commonwealth amounted to approximately \$118 million and \$16.8 million, respectively, which are included in the debt service fund.

For financial reporting purposes, the outstanding amount of bonds represents the total principal to be repaid, net of unamortized premiums, discount, and deferred refunding losses; for capital appreciation bonds, it represents total principal and accreted interest to be repaid.

Bonds payable outstanding at June 30, 2006 are as follows (expressed in thousands):

	<u>General obligation</u>	<u>Revenue bonds</u>	<u>Total</u>
Term bonds payable through 2036; interest payable semiannually at rates varying from 3% to 8%.	\$ 2,818,195	1,588,655	4,406,850
Serial bonds payable through 2024; interest payable semiannually at rates varying from 3.75% to 7.5%.	4,091,580	1,097,975	5,189,555
Capital appreciation bonds payable through 2031; no interest rate, yield ranging from 4.42% to 7.8%. Net of accreted discount of \$190 million.	256,116	163,518	419,634
The Children's Trust Fund tobacco settlement asset-backed bonds payable through 2026; interest payable annually at rates varying from 4.625% to 6%.	—	1,239,015	1,239,015
Capital Fund Program Bonds, maturing in various dates payable through 2024; interest payable at rates varying from 2% to 5%.	—	641,325	641,325
Bond payment obligation payable through 2010; interest payable at rates varying from 1.5% to 5.5%.	125,910	—	125,910
Balance carried forward	\$ 7,291,801	4,730,488	12,022,289

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2006

	<u>General obligation</u>	<u>Revenue bonds</u>	<u>Total</u>
Balance brought forward	\$ 7,291,801	4,730,488	12,022,289
Yield curve bonds payable from 2009 through 2011; no interest rate, yield of 8.914%.	15,000	—	15,000
Yield retail bonds payable from 2009 through 2011; interest payable at rates varying from 2.875% to 5%.	24,000	—	24,000
Tax-exempt components maturing through 2007 and 2008; interest payable at rates ranging from 5.5% to 5.6%.	—	72,160	72,160
Inverse rate bonds payable from 2009 through 2011; interest payable at a rate of 6%.	15,000	—	15,000
Insured bonds payable from 2014 through 2018; interest payable at a rate of 5%.	64,360	—	64,360
Total	7,410,161	4,802,648	12,212,809
Unamortized premium, net	220,204	23,245	243,449
Deferred charges arising from debt refunding	(106,792)	(154,614)	(261,406)
Savings bonds	231	—	231
Total bonds payable	<u>\$ 7,523,804</u>	<u>4,671,279</u>	<u>12,195,083</u>

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2006

During the year ended June 30, 2006, the following changes occurred in the bonds payable (expressed in thousands):

	<b>Outstanding at June 30, 2005</b>	<b>Issued</b>	<b>Premiums/ discount (redemptions)</b>	<b>Outstanding at June 30, 2006</b>
Term bonds	\$ 4,383,350	23,500	—	4,406,850
Serial bonds	5,272,710	78,195	(161,350)	5,189,555
Capital appreciation bonds	412,031	—	7,603	419,634
The Children's Trust Fund tobacco settlement				
asset-backed bonds	1,240,404	—	(1,389)	1,239,015
Capital Fund Program Bonds	663,060	—	(21,735)	641,325
Appropriation refunding bonds	—	—	—	—
Bond payment obligations	125,910	—	—	125,910
Yield curve bonds	15,000	—	—	15,000
Yield retail bonds	26,000	—	(2,000)	24,000
Tax-exempt components	72,160	—	—	72,160
Inverse rate bonds	79,360	—	—	79,360
Subtotal	12,289,985	101,695	(178,871)	12,212,809
Unamortized premium	267,001	—	(23,552)	243,449
Deferred charges arising from debt refunding	(310,096)	—	48,690	(261,406)
Savings bonds	231	—	—	231
Total	\$ 12,247,121	101,695	(153,733)	12,195,083

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Maturities of general obligations and of revenue bonds payable, including accrued interest of capital appreciation bonds, are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ 253,559	610,820	864,379
2008	280,914	593,516	874,430
2009	319,191	559,516	878,707
2010	364,425	537,792	902,217
2011	429,800	518,118	947,918
2012-2016	1,946,707	2,269,971	4,216,678
2017-2021	2,559,212	1,817,195	4,376,407
2022-2026	2,114,438	1,232,503	3,346,941
2027-2031	1,892,647	737,479	2,630,126
2032-2036	1,238,766	372,485	1,611,251
2037-2041	545,847	113,308	659,155
2042-2046	88,515	13,478	101,993
Total	12,034,021	\$ <u>9,376,181</u>	<u>21,410,202</u>
Plus accreted discount	179,019		
Plus unamortized premium	243,449		
Less deferred charges arising from debt refunding	<u>(261,406)</u>		
Total	\$ <u>12,195,083</u>		

### (d) *Commonwealth Appropriation Bonds*

Over the years, GDB, as fiscal agent and bank for the Commonwealth, had extended lines of credit, advances, and loans to several agencies and component units in order to finance their capital improvement projects and to cover their operational deficits at the time. At different points in time, these loans were refunded through the issuance of Commonwealth appropriation bonds issued by the Puerto Rico Public Finance Corporation (PFC), a blended component unit of GDB. PFC is the financing arm of GDB, which serves only as a conduit for the issuance of the bonds.

During June 2004, PFC advance refunded through the PFC 2004 Series A and B and PFC 2003 Series A through C Refunding Commonwealth Appropriation Bonds, a portion of certain of its outstanding Commonwealth Appropriation Bonds issued in prior years (except for the Health Facilities and Services Administration bonds described below, where no portion was refunded). The Commonwealth recognized a mirror effect of this advance refunding by PFC in its own debt in proportion to the portion of the Commonwealth's notes included in the PFC refunding. As a result, the Commonwealth considered defeased and therefore removed from the balance sheet the portion refunded of \$775.7 million. The repayment source for these bonds (both the refunding and unrefunded portions) consists of Commonwealth appropriations submitted for approval of the Legislature annually during the budget preparation process of the Commonwealth. The Legislature is not legally bound to appropriate funds for such repayments.



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

The outstanding balance of the Commonwealth appropriation bonds (both the refunding and unrefunded portion combined) is comprised of the following obligations (expressed in thousands):

Act No. 164 Restructuring	\$	1,481,583
Health Facilities and Services Administration		447,781
Office for the Improvement of Public Schools		328,602
Puerto Rico Maritime Shipping Authority		278,039
Property tax settlement		106,189
Total Commonwealth appropriation bonds	\$	<u>2,642,194</u>

On December 17, 2001, Act No. 164 was approved, which authorized certain government agencies and discretely presented component units to refund approximately \$2.4 billion of their outstanding obligations with GDB, for which no repayment source existed, over a period not exceeding 30 years, and to be repaid with annual Commonwealth appropriations not to exceed \$225 million. This refunding was done with Commonwealth appropriation bonds through several series issued by PFC during the period between December 2001 and June 2002.

Approximately \$1.5 billion of the aforementioned outstanding obligations belonged to the primary government, predominantly the Department of Health of the Commonwealth (health reform financing and other costs for approximately \$1.1 billion) and the Department of the Treasury of the Commonwealth (the fiscal year 2001 deficit financing of \$268 million and the obligation assumed for defective tax liens in the amount of approximately \$132 million). The new combined bonds balance of the Act No. 164 restructuring bears interest at rates ranging from 1.25% to 5.80%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ 23,355	83,725	107,080
2008	35,076	81,944	117,020
2009	37,031	79,997	117,028
2010	34,707	80,860	115,567
2011	35,799	77,198	112,997
2012-2016	229,027	347,762	576,789
2017-2021	311,137	264,451	575,588
2022-2026	373,106	136,893	509,999
2027-2031	421,881	45,922	467,803
Total	1,501,119	\$ <u>1,198,752</u>	<u>2,699,871</u>
Plus unamortized premium	23,234		
Less deferred charges arising from debt refunding	<u>(42,770)</u>		
Total	\$ <u>1,481,583</u>		

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

As of July 1, 1999, approximately \$595 million (including unpaid interest) of a promissory note of the Health Facilities and Services Administration (HFSA) due to GDB was transferred to the Department of Health of the Commonwealth and restructured through Commonwealth appropriation bonds. The bonds bear interest at rates ranging between 5.90% and 6.20%. Principal and interest on the bonds are payable solely from legislative appropriations to be made pursuant to Act No. 223 of August 9, 1998. The act provides that OMB shall include in the annual budget of the Commonwealth an amount equal to \$56.5 million for the fiscal year 1998-99, and for the next succeeding 15 fiscal years the amount necessary to pay the principal of and interest on the bonds, up to a maximum annual amount of \$57.7 million. As of June 30, 2006, approximately \$448 million was still outstanding.

Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ 37,080	20,652	57,732
2008	39,600	18,133	57,733
2009	42,125	15,607	57,732
2010	44,865	12,867	57,732
2011	25,018	32,714	57,732
2012-2016	219,967	65,623	285,590
2017-2018	39,126	76,297	115,423
Total	<u>\$ 447,781</u>	<u>241,893</u>	<u>689,674</u>

Previous public schools infrastructure improvement loans provided additional funds for major repairs and improvements to the public schools in Puerto Rico. This activity is administered by the Office for the Improvement of the Public Schools of Puerto Rico (OIPS), included as part of the general fund of the primary government. These loans were refunded originally through the issuance of Commonwealth appropriation bonds pursuant to Act No. 85 of June 13, 1998 (Act 85). The new combined bonds bear interest at rates ranging from 5.0% to 5.85%. As of June 30, 2006, approximately \$328.6 million was outstanding.

**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2006

Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ 9,470	18,121	27,591
2008	9,945	17,648	27,593
2009	10,465	17,125	27,590
2010	10,990	16,602	27,592
2011	11,580	16,011	27,591
2012-2016	74,025	61,401	135,426
2017-2021	82,620	39,124	121,744
2022-2026	127,060	15,570	142,630
Total	336,155	\$ 201,602	537,757
Plus unamortized premium	6,503		
Less deferred charges arising from debt refunding	(14,056)		
Total	\$ 328,602		

A promissory note payable owed by PRMSA to GDB was assumed by the Commonwealth in connection with the sale of the maritime operations of PRMSA. Commonwealth appropriation bonds were issued to refund this liability. The new combined bonds balance bears interest at a variable rate ranging from 3.00% to 7.30%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ —	16,907	16,907
2008	—	16,907	16,907
2009	—	16,907	16,907
2010	3,415	16,793	20,208
2011	9,390	16,443	25,833
2012-2016	59,910	74,728	134,638
2017-2021	81,845	56,221	138,066
2022-2026	103,990	31,993	135,983
2027-2030	69,945	5,138	75,083
Total	328,495	\$ 252,037	580,532
Less unamortized discount	(643)		
Less deferred charges arising from debt refunding	(49,813)		
Total	\$ 278,039		

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

During fiscal year 1996, the Commonwealth refinanced the liability for the settlement of the property taxes owed to the municipalities of Puerto Rico. Commonwealth appropriation bonds were issued to refund this liability. The new combined bonds balance bears interest at rates ranging from 5.87% to 7.25%. Debt service requirements in future years are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ 14,285	4,103	18,388
2008	15,350	3,040	18,390
2009	16,505	1,885	18,390
2010	17,750	643	18,393
2011	13,813	4,582	18,395
2012-2016	47,432	26,152	73,584
Total	125,135	\$ 40,405	165,540
Plus accreted discount	7,412		
Less deferred charges arising from debt refunding	(26,358)		
Total	\$ 106,189		

### (e) *Qualified Zone Academy Bonds*

During November 2001, the Department of Education of the Commonwealth issued a certification whereby certain Commonwealth public schools were designated as a “qualified zone academy” pursuant to Section 1397E of the U.S. Internal Revenue Code of 1986, as amended. On May 18, 2004, PFC, a blended component unit of GDB, issued \$47.9 million of Qualified Zone Academic Bonds (QZAB) to finance expenditures of the Department of Education of the Commonwealth under the aforementioned program, including rehabilitation and repairs of school buildings and other facilities, the development and implementation of academic curricula, technology training for some schools, and the costs of issuance of the bonds. This May 2004 QZAB is payable upon its maturity on May 2020, since the U.S. government grants tax exemptions to bond holders in lieu of an interest rate. Beginning in August 2004, annual appropriations from the general fund in the amount of approximately \$2.2 million are expected to be made over the next 16 years and deposited in an escrow account, which along with accumulated earned interest will be sufficient to repay these bonds upon their maturity in 2020.

During January 2006, another QZAB in the amount of \$39.4 million was issued for similar purposes. The January 2006 QZAB is payable upon its maturity in January 2022. Beginning in fiscal year 2007, annual appropriations from the general fund in the amount of \$2.1 million are expected to be made over the next 16 years and deposited in an escrow account, which along with accumulated earned interest will be sufficient to repay these bonds upon its maturity in 2022.

Also during January 2006, the Commonwealth unwinded the 2001 defeasance of the QZAB issued in December 2001, therefore, reverting back the transaction and recognizing in the statement of net assets for the governmental activities such QZAB obligation in the amount of \$96.8 million.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Beginning in fiscal year 2007, annual appropriations from the general fund in the amount of \$8.1 million are expected to be made over the next 10 years and deposited in an escrow account, which along with accumulated earned interest will be sufficient to repay these bonds upon their maturity in 2016. See more details about this transaction, which has been classified as a special item, in note 23.

**(f) Notes Payable to Component Units**

The Commonwealth has entered into various interim line of credit agreements with GDB. One \$800 million line of credit with the Department of the Treasury had drawings and repayments within the same year for the same amount of \$1.3 billion. These drawings and repayments related to advances in anticipation of the 2006 TRANS and to cover temporary cash deficiencies between tax collections and payments of current expenditures, which were later repaid upon the TRANS issuance and the actual tax collection and replenishment of the aforementioned deficiency. The remaining interim financing outstanding at June 30, 2006 consisted of the following (expressed in thousands):

Agency	Purpose	Interest rate	Line of credit	Outstanding balance
Department of the Treasury	Revolving advances in anticipation of TRANS	175bp over GDB's commercial paper rate	\$ 695,000	319,741
Department of the Treasury	Resources to meet appropriations in annual budget of Commonwealth (Fiscal year 2004) and Federal program expenditures	125bp over three-month LIBOR	640,000	156,744
Public Building Authority	Interim construction activities	150bp over GDB's	256,000	30,598
Department of Transportation and Public Works	Construction and repavement of roads	150bp over GDB's commercial paper rate	15,000	15,000
Department of Recreation and Sports	Recreational projects at various municipalities	150bp over GDB's commercial paper rate	16,000	3,961
			<u>\$ 1,622,000</u>	<u>526,044</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

The Commonwealth financed certain other long-term liabilities through GDB and other component units. The outstanding balance on the financing provided by GDB is comprised of the following (expressed in thousands), all within governmental activities:

### GDB:

Department of the Treasury	\$ 2,570,623
Department of Education	126,575
Public Building Authority	75,000
Department of Transportation and Public Work	72,190
Department of Agriculture	67,022
Office of Management & Budget	54,915
Department of Health	39,682
Puerto Rico Court Administration Office	37,867
Department of Justice	37,549
Correction Administration	21,292
Department of Recreation and Sports	18,241
Office of the Superintendent of the Capitol	17,338
Police Department	14,553
Department of Natural Resources	12,121
Administration for the Care and Development of the Childhood	5,257
Public Housing Administration	4,183
State Office for the Historic Conservation	3,540
Office of Veterans' Affairs	1,135
Notes Payable to GDB	<u>\$ 3,179,083</u>

### Other Components Unit:

Health facilities agreement payable to the Medical Science	
Campus of UPR	\$ 71,570
Note payable to PREPA	<u>43,081</u>
Notes payable to other component unit	<u>\$ 114,651</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

As of June 30, 2006, the Department of the Treasury of the Commonwealth has entered into various line of credit agreements with GDB amounting to a maximum of \$3 billion for different purposes as presented in the following tables. The purpose, interest rate, maturity date, and amount outstanding under each individual agreement at June 30, 2006 consist of the following (expressed in thousands):

Purpose	Interest rate	Maturity	Line of credit	Outstanding balance
To finance payroll and operational expenditures of the Commonwealth for fiscal period 2006	5.50%	June 30, 2036	\$ 741,000	741,000
To provide additional resources to meet the appropriations in the annual budget of the Commonwealth (fiscal year 2005)	125 bp over three-month LIBOR	June 30, 2014	550,000	550,000
Resources for repayment of agencies' old debts	125 bp over three-month LIBOR	September 30, 2015	368,200	368,200
Replenishment of income tax refund reserve (fiscal year 2004)	125 bp over three-month LIBOR	June 30, 2008	250,000	238,924
Resources to meet appropriations in annual budget of Commonwealth and partial repayments of TRANS (fiscal year 2004)	125 bp over three-month LIBOR	June 31, 2009	233,000	233,000
Capital improvement projects of agencies and municipalities	150 bp over GDB's commercial paper rate	June 30, 2019	130,000	96,187
Acquisition of safety and security equipment for certain Commonwealth agencies	150 bp over GDB's commercial paper rate	September 30, 2007	105,000	94,552
Resources to cover the operational needs of the catastrophic disasters fund (fiscal year 2004)	125bp three-month LIBOR	July 31, 2006	100,000	78,130
Balance brought forward			\$ 2,477,200	2,399,993



**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2006

<b>Purpose</b>	<b>Interest rate</b>	<b>Maturity</b>	<b>Line of credit</b>	<b>Outstanding balance</b>
Balance brought forward			\$ 2,477,200	2,399,993
To meet program expenditures of the Puerto Rico Health Insurance Administration and the Department of the Family	125bp over three-month LIBOR	September 30, 2015	79,930	45,716
To cover deficit in certain elderly and child care programs of the Department of the Family	125 bp over three-month LIBOR	September 30, 2011	30,000	29,928
To fund information technology project	150 bp over GDB's commercial paper rate	September 30, 2008	44,868	22,333
To pay debt with Municipal Revenue Collection Center	125 bp over three-month LIBOR	September 30, 2011	16,241	16,241
Resources to various agencies to pay outstanding debt with PBA	125bp over three-month LIBOR	September 30, 2008	40,000	14,182
To estimate economy in municipalities of Ceiba and Naguabo	125 bp over three-month LIBOR	September 30, 2012	14,500	12,665
To pay outstanding debt of various agencies with the Puerto Rico Telephone Company	125 bp over three-month LIBOR	September 30, 2008	16,000	12,157
To acquire correctional facilities	125 bp over three-month LIBOR	September 30, 2012	15,000	11,552
Resources to cover the operational needs of the catastrophic disasters fund (fiscal year 2004)	125 bp over three-month LIBOR	July 31, 2006	8,000	5,825
Purchase of mobile X-ray machines	125bp over three-month LIBOR	June 30, 2008	12,000	31
			<u>\$ 2,753,739</u>	<u>2,570,623</u>

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

On February 6, 2003, the Department of Education of the Commonwealth entered into a \$25 million line-of-credit agreement with GDB for the purchase of equipment and for school improvements. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2008. As of June 30, 2006, \$11.6 million was outstanding. The line-of-credit agreement will be repaid from future legislative appropriations. On August 4, 2002, the Department of Education entered into an additional \$140 million line-of-credit agreement with GDB in order to reimburse the Department of the Treasury for payments made on their behalf for state funds used to fund federal program expenditures. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on June 30, 2007. As of June 30, 2006, \$115 million was outstanding related to the borrowing. The line-of-credit will be repaid with federal grants. On August 30, 2002, the Department of Education also entered into a \$2.3 million line-of-credit agreement with GDB for the construction of school facilities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on July 1, 2006. At June 30, 2006, no amounts had been drawn under this line-of-credit.

On April 6, 2006, the Public Building Authority executed a loan agreement with GDB for \$75 million bearing interest at a variable rate based on 125 basis points over the three-month LIBOR index. The loan, obtained for operational needs, is due on June 30, 2010 and is collateralized with two of PBA's properties. Debt service requirements will come from Commonwealth appropriations. On June 30, 2006, PBA exchanged one of the collateralized properties in partial settlement of \$30 million of the loan, upon which a gain of \$8.7 million resulted and was recognized in the accompanying statement of activities. At that moment, PBA borrowed an additional \$30 million. At June 30, 2006, \$75 million remained outstanding.

On March 8, 2004, the Department of Transportation and Public Works (DTPW), entered into a \$26 million line-of-credit agreement with GDB for the improvement and maintenance of the roads around the island. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2010. As of June 30, 2006, this line-of-credit has an outstanding balance of approximately \$22 million. On November 16, 2004, the DTPW entered into another \$33 million line-of-credit agreement with GDB for similar purposes. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on October 31, 2010. As of June 30, 2006, \$12 million remains outstanding related to these borrowings. On June 23, 2005, the DTPW entered into an additional \$44 million line-of-credit agreement with GDB to meet program expenditures. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 2.5% and are payable upon the maturity of the line of credit on September 30, 2008. As of June 30, 2006, this line-of-credit has an outstanding balance of approximately \$38 million.

On August 9, 1999, the Department of Agriculture of the Commonwealth entered into a \$125 million nonrevolving line-of-credit agreement with GDB to provide economic assistance to the agricultural sector which sustained severe damages caused by Hurricane Georges in 1998. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on June 30, 2014. As of June 30, 2006, \$67 million remains outstanding. The line-of credit will be repaid from future legislative appropriations.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

On June 5, 2006, the Office of Management and Budget entered into a \$150 million line-of-credit agreement with GDB to provide economic assistance for disasters and emergencies. Borrowings under this line-of-credit agreement bear interest at variable rates based on 125 basis points over three-month LIBOR, and are payable upon the maturity of the line-of-credit on September 30, 2011. As of June 30, 2006, \$54.9 million was outstanding.

On August 2003, the Department of Health of the Commonwealth entered into a \$30 million line-of-credit agreement with GDB in order to repay certain outstanding debts that the Puerto Rico Medical Services Administration (PRMSA) had with other agencies and suppliers. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon maturity of the line-of-credit on June 30, 2012. As of June 30, 2006, \$28.9 million related to this line-of-credit agreement was outstanding. On November 8, 2004, the Department of Health entered into an additional \$58.5 million line-of-credit agreement with GDB for the financing of a project of the Department of Health and PRMSA. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on October 31, 2014. As of June 30, 2006, this line-of-credit agreement amounted to \$10.8 million.

On May 7, 2001, the Puerto Rico Court Administration Office (the Office) entered into a \$49.4 million nonrevolving line-of-credit agreement with GDB for operating purposes. Borrowings under this line-of-credit agreement bear interest at a variable rate of three-month London Inter bank Offered Rate (LIBOR) plus 1%, not to exceed 8%. The Office must deposit \$6 million a year, from the total fees collected on the filing of civil cases, in a special fund created by the Department of the Treasury of the Commonwealth, which is pledged for repayment until July 31, 2015. As of June 30, 2006, approximately \$38 million remains outstanding.

On October 2, 2002, the Department of Justice of the Commonwealth entered into a \$90 million line-of-credit agreement with GDB for the financing of 12 public improvement projects for the Municipality of Ponce pursuant to a court order. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on September 30, 2014. As of June 30, 2006, \$21.5 million related to this line of credit agreement was outstanding. The line-of-credit will be repaid from future Commonwealth appropriations. On July 8, 2005, the Department of Justice entered into an additional \$63.4 million line-of-credit agreement with GDB for various projects in Ponce. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2014. As of June 30, 2006, this line-of-credit agreement amounted to \$16 million.

On August 28, 2000, GDB approved an amendment to the terms of two line-of-credit agreements of the Correction Administration by which such debts would be repaid between fiscal years 2000 and 2007. The two agreements were issued by GDB in August 1998 to partially fund permanent improvements to correctional facilities. The agreements have variable interest rates and limits of \$60 million and \$15 million. Their outstanding balance as of June 30, 2006 is \$7.5 million. On May 12, 2004, the Correction Administration entered into an additional \$60 million line-of-credit agreement with GDB for improvements to certain correctional facilities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on June 30, 2010. As of June 30, 2006, \$13.8 million was outstanding. The line-of-credit will be repaid from future Commonwealth appropriations.

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

On October 23, 2002, the Department of Recreation and Sports of the Commonwealth (DRS) entered into a \$17.5 million line-of-credit agreement with GDB for the development of a recreational complex and other facilities in San Juan, which will eventually become the DRS' principal office headquarters. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on September 30, 2008. As of June 30, 2006, \$14.4 million remains outstanding. The line-of-credit will be repaid from future Commonwealth appropriations. On January 18, 2005, the DRS also entered into a \$17.2 million line-of-credit agreement with GDB for the development of a series of recreational projects at different municipalities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on June 30, 2010. As of June 30, 2006, \$2.2 million was outstanding. On May 25, 2006, the DRS entered into an additional \$3 million line-of-credit agreement with GDB for the development of a series of recreational projects at different municipalities. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2008. As of June 30, 2006, \$1.6 million was outstanding.

On June 21, 2001, the Office of the Superintendent of the Capitol (Superintendent) entered into a \$10 million line-of-credit agreement with GDB for the construction of a parking lot. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 8% and are payable from future Commonwealth appropriations commencing in fiscal year 2003 through fiscal year 2007. As of June 30, 2006, \$5.1 million related to the line-of-credit agreement was outstanding. On February 15, 2002, the Superintendent entered into an additional \$35 million line-of-credit agreement with GDB for the acquisition and remodeling of several buildings under their jurisdiction. Borrowings under this line-of-credit agreement bear interest at a fixed rate of 8% and are payable from future legislative appropriations commencing in fiscal year 2003 through fiscal year 2008. As of June 30, 2006, \$12.2 million remained outstanding from the line-of-credit agreement.

On June 10, 2004, the Police Department entered into a \$48 million line-of-credit agreement with GDB for the acquisition of vehicles and high technology equipment. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of credit on September 30, 2014. The outstanding balance of this line-of-credit agreement amounted to \$14.6 million at June 30, 2006.

On August 21, 2002, the Department of Natural and Environmental Resources of the Commonwealth (DNER) entered into a \$22.7 million line-of-credit agreement with GDB for the canalization of the Bucana River. Borrowings under this line of credit agreement bear interest at variable rates and were payable upon the maturity of the line-of-credit on June 30, 2007. As of June 30, 2006, \$8.3 million remains outstanding under the line-of-credit agreement. The line-of-credit will be repaid from future Commonwealth appropriations. On September 3, 2003, the DNER entered into a \$2 million line-of-credit agreement with GDB for the canalization of Guayanilla River. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line of-credit on June 30, 2007. As of June 30, 2006, \$1 million was outstanding. On August 22, 2005, the DNER entered into an additional \$3.5 million line-of-credit agreement with GDB for the canalization of Fajardo River. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on September 30, 2007. As of June 30, 2006, \$2.8 million was outstanding.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

On February 24, 2006 the Administration for the Care & Development of the Childhood entered into an \$8 million line-of-credit agreement with GDB to provide economic assistance for the summer program known as "Care and Development of the Child Program". Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on September 30, 2009. As of June 30, 2006, \$5.3 million was outstanding.

The Public Housing Administration has available a \$97.1 million of a line-of-credit secured by The Department of Housing and Urban Development of the United States. It bears interest at the daily weighted average rate of the GDB outstanding commercial paper notes plus a required margin cost (5.67% at June 30, 2006). At June 30, 2006, the outstanding balance under this line of credit was \$4.1 million.

On August 1, 2001, the State Office for the Historic Conservation entered into a \$4.5 million line-of-credit agreement with GDB for the construction and conservation of the Santa Catalina Palace and the Real Audiencia building. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on December 31, 2008. As of June 30, 2006, the outstanding balance of this line-of-credit agreement amounts to \$3.5 million. The line-of-credit will be repaid from future Commonwealth appropriations.

On October 20, 2004, the Office of Veterans' Affairs entered into a \$1.6 million line-of-credit agreement with GDB to provide economic assistance and housing-leasing services to Puerto Rican veterans. Borrowings under this line-of-credit agreement bear interest at variable rates and are payable upon the maturity of the line-of-credit on June 30, 2006. As of June 30, 2006, \$1.1 million was outstanding.

As of July 1, 1999, debts of approximately \$102 million from various agreements payable to UPR, a discretely presented component unit, in relation to outstanding noninterest-bearing debt accumulated in prior years by HFSA were transferred to the Commonwealth. On September 7, 2004, additional debts of approximately \$71.2 million were also restructured and combined with the previous financing arrangement. During fiscal year 2006, an installment of \$15.6 million was paid by the Commonwealth under this arrangement. As of June 30, 2006, \$71.6 million remains outstanding. Future amounts required to pay principal balances at June 30, 2006 are as follows (expressed in thousands):

Year ending June 30:		
2007	\$	15,570
2008		15,570
2009		7,570
2010		7,570
2011		7,570
2012-2014		17,720
Total	\$	<u>71,570</u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

The noninterest-bearing note payable to PREPA, a discretely presented component unit, consists of \$19 million of fuel adjustment subsidy due by the Commonwealth and the refinancing during 2004 of \$24.1 million of other accumulated debt by the Commonwealth's agencies with PREPA. Future amounts required to pay principal balances at June 30, 2006 are as follows (expressed in thousands):

Year ending June 30:		
2007	\$	6,327
2008		6,327
2009		6,327
2010		24,100
Total	\$	<u>43,081</u>

**(g) *Compensated Absences***

Long-term debt includes approximately \$1,691 million accrued vacation and sick leave benefits at June 30, 2006. The total liability of compensated absences recorded as governmental and business-type activities amounted to \$1,684 million and \$7 million, respectively.

**(h) *Net Pension Obligation***

The amount reported as net pension obligation of approximately \$4.7 billion represents the cumulative amount owed by the Commonwealth for the unfunded prior years' actuarially required pension contributions to the ERS and the TRS (collectively known as the pension plans) (see note 19). The net pension obligation has been recorded as a liability in governmental activities in the accompanying statement of net assets.

**(i) *Unpaid Lottery Prizes***

The amount reported as unpaid lottery prizes represents the lottery prizes payable of the Lottery of Puerto Rico (commonly known as Traditional Lottery) and the additional lottery system (commonly known as Lotto) jointly known as the Lottery Systems at June 30, 2006. The minimum annual payments related to unpaid awards of both lotteries are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ 37,488	—	37,488
2008	32,890	1,733	34,623
2009	31,297	3,326	34,623
2010	29,806	4,817	34,623
2011	24,409	10,214	34,623
2012-2016	98,363	39,386	137,749
2017-2021	40,602	33,186	73,788
2022-2026	8,848	11,725	20,573
Total	\$ <u>303,703</u>	<u>104,387</u>	<u>408,090</u>



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

The liability for unpaid lottery prizes is reported in the accompanying statement of net assets and the statement of net assets – business-type activities – proprietary funds.

### (j) *Claims Liability for Insurance Benefits*

The Commonwealth provides unemployment compensation, nonoccupational disability, and drivers' insurance coverage to public and private employees through various insurance programs administered by the Department of Labor and Human Resources of the Commonwealth. These insurance programs cover workers against unemployment, temporary disability, or death because of work or employment-related accidents or because of illness suffered as a consequence of their employment.

The Commonwealth establishes liabilities for incurred but unpaid benefits and benefit adjustment expenses based on the ultimate cost of settling the benefits. Insurance benefit claim liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. The liability for insurance benefits claims is reported as a current liability in the accompanying statement of net assets and the statement of net assets – business-type activities – proprietary funds.

### (k) *Obligations Under Capital Lease Arrangements*

The Commonwealth is obligated under capital leases with third parties that expire through 2034 for land, buildings, and equipment. At June 30, 2006, the capitalized cost of the land, buildings, and equipment amounted to approximately \$165 million and is included in the accompanying government-wide statement of net assets within capital assets.

The present value of future minimum capital lease payments at June 30, 2006 reported in the accompanying government-wide statement of net assets is as follows (expressed in thousands):

Year ending June 30:	
2007	\$ 4,476
2008	15,365
2009	14,331
2010	14,068
2011	13,660
2012-2016	66,495
2017-2021	59,782
2022-2026	56,934
2027-2031	52,516
2032-2034	18,057
Total future minimum lease payments	315,684
Less amount representing interest costs	(171,183)
Present value of minimum lease payments	\$ 144,501



**COMMONWEALTH OF PUERTO RICO**

Notes to Basic Financial Statements

June 30, 2006

Leased land, buildings, and equipment under capital leases in capital assets at June 30, 2006, include the following (expressed in thousands):

Land	\$	7,960
Buildings		146,202
Equipment		11,060
		<hr/>
Subtotal		165,222
Less accumulated amortization		(25,738)
		<hr/>
Total	\$	<u>139,484</u>

Amortization charge applicable to capital leases and included within depreciation expense of capital assets amounted to approximately \$6 million in 2006.

The Commonwealth is also committed under numerous operating leases, covering land, office facilities, and equipment. Rental expenditures within the governmental funds for the year ended June 30, 2006 under such operating leases were approximately \$145 million.

The future minimum lease payments for these leases are as follows (expressed in thousands):

Year ending June 30:

2007	\$	93,160
2008		74,839
2009		54,279
2010		30,177
2011		19,074
2012-2016		49,201
2017-2021		4,848
2022-2026		2,923
		<hr/>
Total future minimum lease payments	\$	<u>328,501</u>

**(I) Other Long-term Liabilities**

The remaining long-term liabilities of governmental activities at June 30, 2006 include (expressed in thousands):

Employees' Christmas bonus	\$	102,562
Liability for federal cost disallowances		53,047
Liability for legal claims and judgments (note 18)		801,167
Liability to U.S. Army Corps of Engineers (note 12)		205,000
		<hr/>
Total	\$	<u>1,161,776</u>

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

As described in note 12, the Commonwealth has a debt obligation with the U.S. Army Corps of Engineers in relation to the construction of the Cerrillos Dam and Reservoir project and the Portugues river and the Bucana river projects.

**(m) *Advance Refunding, Defeased Bonds, and Refunding of Special Promissory Notes***

In prior years, the Commonwealth defeased certain general obligation and other bonds by placing the proceeds of bonds in an irrevocable trust to provide for all future debt service payments on the refunded bonds. Accordingly, the trusts' account assets and liabilities for the defeased bonds are not included in the basic financial statements. At June 30, 2006, approximately \$1.4 billion of bonds outstanding from prior years advance refunding are considered defeased.

In addition, PBA, a blended component unit, has defeased certain revenue bonds in prior years by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old debts. Accordingly, the trusts' account assets and liabilities for the defeased bonds are not included in the statement of net assets. As of June 30, 2006, approximately \$656 million of PBA bonds are considered defeased.

#### **Fiduciary Funds**

On June 29, 2006, the GRS entered into a line of credit agreement with a commercial bank for a amount not to exceed \$112 million at a variable rate subject to LIBOR plus the Applicable Margin (50 basis point in the case of LIBOR rate or 0 basis points in the cases of Base Rate Advances). At June 30, 2006, the outstanding balance of the line of credit amounts to \$60 million.

On August 1, 1996, the TRS entered into a loan agreement with AFICA, a discretely presented component unit, to secure AFICA's issuance of \$26.9 million of industrial revenue term bonds. The bonds were issued under a trust agreement and are secured by a pledge of certain marketable securities of the TRS.

The proceeds from the sale of the bonds were lent by AFICA to TRS to finance the acquisition of certain buildings and related facilities and to pay certain expenses incurred in connection with the issuance and sale of the bonds.

Bonds payable outstanding at June 30, 2006, are as follows (expressed in thousands):

Term Bonds Series A payable through 2012, interest payable on a monthly basis at rates varying from 6.50% to 6.65%	\$ 5,220
Term Bonds Series B payable through 2021, interest payable semiannually at 5.50%	<u>15,210</u>
Total	<u><u>\$ 20,430</u></u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Maturities of the term bonds are as follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ 915	1,184	2,099
2008	975	1,123	2,098
2009	1,040	1,058	2,098
2010	1,110	989	2,099
2011	1,180	915	2,095
2012-2016	6,575	3,499	10,074
2017-2021	8,635	1,476	10,111
Total	<u>\$ 20,430</u>	<u>10,244</u>	<u>30,674</u>

The Series A and Series B Bonds are subject to redemption, at the option of the TRS, in whole or in part on July 1, 2006, or any date thereafter at the determined redemption prices plus accrued interest to the redemption date as follows:

July 1, 2006 through June 30, 2007	102%
July 1, 2007 through June 30, 2008	101
July 1, 2008 and thereafter	100

The TRS has also entered into a \$15 million line-of-credit agreement with GDB, due on October 31, 2010, and guaranteed by a pool of investments of the TRS. At June 30, 2006, the outstanding balance of the line of credit was approximately \$4 bearing interest at a variable rate subject to LIBOR, but not less than an annual interest rate of 5%.

### Discretely Presented Component Units

Notes and bonds payable are those liabilities that are paid out of resources pledged by the other component units. These notes and bonds do not constitute a liability or debt of the Commonwealth.

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

The outstanding balance of notes payable at June 30, 2006 is as follows (expressed in thousands):

Component unit	Interest rate	Maturity through	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Government Development Bank for Puerto Rico	4.1% – 5.85%	2031	\$ 1,212,677	14,901,196	13,378,916	2,734,957	1,048,867
Puerto Rico Electric Power Authority	2.60% – 5.47%	2013	41,585	200,000	4,750	236,835	204,835
State Insurance Fund Corporation	Discounted notes from 6.31% – 6.84%	2019	55,252	—	1,660	53,592	1,956
Economic Development Bank for Puerto Rico	4.20% – 5.20%	2025	400,000	200,000	100,000	500,000	—
Puerto Rico Industrial Development Company	5.00% – 6.73%	2024	63,033	7,319	2,033	68,319	2,693
Land Authority of Puerto Rico	4.87	2010	10,604	—	2,121	8,483	2,121
Puerto Rico Ports Authority	5.72% – 7.5%	2024	122,763	18,400	6,214	134,949	122,464
Agricultural & Services Development Co.	Variable	2007	—	10,238	—	10,238	—
Puerto Rico Trade & Export Company	5.20% – 5.80%	2026	—	400,000	—	400,000	—
Total notes payable – component units			\$ 1,905,914	15,737,153	13,495,694	4,147,373	1,382,936

Notes payable of \$175 million of PREPA, not included in the table above, have no fixed maturity date and variable interest rates. For financial reporting purposes, these notes have been classified as due within one year. These had increases of \$25 million during 2006.

Debt service requirements on component units' notes payable with fixed maturities at June 30, 2006 were as follows (expressed in thousands):

	Principal	Interest	Total
Year ending June 30:			
2007	\$ 1,557,936	179,214	1,737,150
2008	131,875	124,984	256,859
2009	132,479	122,287	254,766
2010	86,847	120,008	206,855
2011	76,452	118,768	195,220
2012-2016	473,876	618,878	1,092,754
2017-2021	86,560	503,094	589,654
2022-2026	901,038	419,801	1,320,839
2027-2031	885,000	243,482	1,128,482
Premium/discount	(9,690)	—	(9,690)
Total	\$ 4,322,373	2,450,516	6,772,889

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Commonwealth appropriation bonds payable outstanding at June 30, 2006 are as follows (expressed in thousands):

Component unit	Interest rate	Maturity through	Beginning balance	Additions	Reductions	Ending balance	Due within one year
Puerto Rico Aqueduct and Sewer Authority	5.50%	2031	\$ 709,276	—	2,508	706,768	2,733
Tourism Company of Puerto Rico	4% – 6.15%	2031	126,918	181	572	126,527	489
Land Authority of Puerto Rico	4% – 6.15%	2031	161,432	3,429	1,526	163,335	718
Government Development Bank of Puerto Rico	4% – 6.15%	2031	10,339	—	95	10,244	45
Puerto Rico Infrastructure Financing Authority	4% – 6%	2031	10,651	—	98	10,553	46
Puerto Rico Solid Waste Authority	1.25% – 5.75%	2031	7,702	—	1	7,701	—
Total appropriation bonds – component units			\$ 1,026,318	3,610	4,800	1,025,128	4,031

Debt service requirements on component units' appropriation bonds payable with fixed maturities at June 30, 2006 were as follows (expressed in thousands):

	Principal	Interest	Total
Year ending June 30:			
2007	\$ 4,031	55,132	59,163
2008	13,316	57,667	70,983
2009	16,027	56,840	72,867
2010	15,511	57,526	73,037
2011	13,512	56,758	70,270
2012-2016	111,428	240,832	352,260
2017-2021	159,540	192,123	351,663
2022-2026	202,901	139,917	342,818
2027-2031	506,914	58,652	565,566
2032-2036	2,272	41	2,313
Deferred loss, net	(43,295)	—	(43,295)
Premium, net	22,971	—	22,971
Total	\$ 1,025,128	915,488	1,940,616

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

Bonds payable outstanding at June 30, 2006 are as follows (expressed in thousands):

Component unit	Interest rate	Maturity through	Beginning balance (as restated)	Additions	Reductions	Ending balance	Amounts due within one year
Government Development for Puerto Rico	2.10% – 7.50%	2,037	\$ 1,458,049	264,191	342,143	1,380,097	94,111
Puerto Rico Infrastructure Financing Authority	1.10% – 7.90%	2,045	2,587,892	23,848	29,483	2,582,257	30,695
University of Puerto Rico	3% – 5.75%	2,030	483,272	—	17,086	466,186	20,625
Puerto Rico Municipal Finance Authority	3.50% – 8.62%	2,030	1,248,977	764,128	396,541	1,616,564	114,210
Puerto Rico Ports Authority	5.00% – 7.30%	2,021	70,260	194	4,250	66,204	4,545
Puerto Rico Aqueduct and Sewer Authority	3.5% – 8.22%	2,045	863,257	—	33,899	829,358	26,641
Puerto Rico Highway and Transportation Authority	2.25% – 6.50%	2,045	5,834,915	1,625,594	819,297	6,641,212	98,520
Puerto Rico Industrial Development Company	1.50% – 6.71%	2,028	298,541	1,889	10,458	289,972	10,458
Puerto Rico Convention Center Company	4.00% – 5.00%	2,037	—	482,801	212	482,589	—
Puerto Rico Electric Power Authority	3.00% – 7.00%	2,035	5,263,374	—	106,844	5,156,530	377,532
Total bonds – component units			\$ 18,108,537	3,162,645	1,760,213	19,510,969	777,337

Debt service requirements on component units' bonds payable with fixed maturities at June 30, 2006, were as follows (expressed in thousands):

	Principal	Interest	Total
Year ending June 30:			
2007	\$ 777,337	1,127,138	1,904,475
2008	536,222	966,116	1,502,338
2009	552,834	952,720	1,505,554
2010	545,949	927,515	1,473,464
2011	568,156	1,060,203	1,628,359
2012-2016	3,517,386	3,865,021	7,382,407
2017-2021	3,351,294	3,070,840	6,422,134
2022-2026	3,534,938	2,277,877	5,812,815
2027-2031	2,756,850	1,926,583	4,683,433
2032-2036	2,068,325	1,251,417	3,319,742
2037-2041	1,474,235	600,125	2,074,360
2042-2046	402,903	312,992	715,895
2047-2051	178,653	—	178,653
Premium/(discount), net	(754,113)	—	(754,113)
Total	\$ 19,510,969	18,338,547	37,849,516

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## Notes to Basic Financial Statements

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The bonds payable amount of Puerto Rico Infrastructure Financing Authority as of beginning of the year was decreased by approximately \$829.3 million, in order to recognize retroactively the effect of a June 30, 2005 defeasance not previously recognized. This is part of the net assets restatements described in note 4.

Several component units have defeased certain revenue bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service payments on the old debts. Accordingly, the trust accounts' assets and liabilities for the defeased bonds are not included in the statement of net assets. As of June 30, 2006, the following bonds are considered defeased:

	<b>Amount outstanding</b> (In millions)
Puerto Rico Electric Power Authority	\$ 1,353
Puerto Rico Highway and Transportation Authority	1,158
Puerto Rico Infrastructure Finance Authority	818
Puerto Rico Municipal Finance Agency	441
Puerto Rico Industrial Development Company	175
	<u>\$ 3,945</u>

### (15) Guaranteed and Appropriation Debt

#### (a) *Guaranteed Debt*

The Commonwealth may provide guarantees for the repayment of certain borrowings of component units to carry out designated projects. At June 30, 2006, the following component unit debts are guaranteed by the Commonwealth (expressed in thousands):

	<b>Maximum guarantee</b>	<b>Outstanding balance</b>
Blended component unit Public Buildings Authority	\$ 3,325,000	2,851,121
Discretely presented component units:		
Puerto Rico Aqueduct and Sewer Authority	801,084	692,774
Port of the Americas Authority	250,000	23,848
Government Development Bank for Puerto Rico	342,000	267,000
Total	<u>\$ 4,718,084</u>	<u>3,834,743</u>



# COMMONWEALTH OF PUERTO RICO

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The Commonwealth has guaranteed the payments of rentals of its departments, agencies, and component units to PBA, a blended component unit, under various lease agreements executed pursuant to the law that created PBA. Such rental payments include the amounts required by PBA for the payment of principal and interest on the guaranteed debt as authorized by law. The rental commitment to cover principal and interest on the guaranteed debt (excluding premiums and deferred refunding losses) as of June 30, 2006 and for the next five years and thereafter follows (expressed in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2007	\$ 56,855	152,464	209,319
2008	73,057	138,934	211,991
2009	80,684	134,992	215,676
2010	86,740	128,119	214,859
2011	89,455	123,273	212,728
2012-2016	318,442	484,229	802,671
2017-2021	397,340	488,678	886,018
2022-2026	396,700	392,901	789,601
2027-2031	494,190	288,261	782,451
2032-2036	593,624	188,197	781,821
2037-2040	297,400	14,263	311,663
	<u>2,884,487</u>	<u>2,534,311</u>	<u>\$ 5,418,798</u>
Add (deduct) accreted discount	37,821	(37,821)	
Unamortized premiums, discounts, and deferred losses, net	<u>(71,187)</u>	<u>—</u>	
	<u>\$ 2,851,121</u>	<u>2,496,490</u>	

Rental income of PBA funds amounted to approximately \$314 million during the year ended June 30, 2006, of which \$173 million was used to cover debt service obligations.

Act No. 45 of July 28, 1994 states that the Commonwealth guarantees the payment of principal and interest of all outstanding bonds at the date the law was enacted and of all future bond issues to refinance those outstanding bonds of PRASA. During December 1995, PRASA issued refunding bonds to refinance all outstanding bonds amounting to approximately \$400.3 million. The outstanding balance of these refunding bonds at June 30, 2006, amounted to \$277 million. Act No. 140 of August 3, 2000, amended Act No. 45 to extend the Commonwealth guarantee to include the principal and interest payments of the Rural Development Serial Bonds and the loans under the State Revolving Fund Program (SRFP) outstanding at the effective date of Act No. 140, and of all future bonds and SRFP loans that may be issued until June 30, 2005. Act No. 386 of September 21, 2004, extended the Commonwealth guarantee to June 30, 2010. The outstanding balance of the Rural Development Serial Bonds and SRFP loans at June 30, 2006, amounted to \$208 million and \$188 million, respectively.

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The Commonwealth guarantees the Adjustable Refunding Bonds, Series 1985, issued by GDB, a discretely presented component unit. The outstanding balance of these bonds amounts to \$267 million at June 30, 2006. The Puerto Rico Housing Bank, a former component unit of the Commonwealth, which merged with and into GDB during 2002, insured mortgages granted to low- and moderate-income families through its mortgage loan insurance program. The Commonwealth guarantees up to \$75 million of such mortgage loans. As of June 30, 2006, the mortgage loan insurance program was insuring loans aggregating \$480.5 million. Currently, the Commonwealth has not been called to make any direct payments pursuant to these guarantees.

At various times during fiscal years ended 2005 and 2006, the Port of the Americas Authority, currently a unit of the Puerto Rico Infrastructure Financing Authority, entered into bond purchase agreements with GDB, whereby GDB agreed to disburse to the Port of the Americas Authority from time to time certain bond principal advances up to a maximum aggregate principal amount of \$70 million (Port of the Americas Authority 2005 Series A Bond), \$40 million (Port of the Americas Authority 2005 Series B Bond) and \$140 million (Port of the Americas Authority 2005 Series C Bond). The proceeds of the bonds are to be used to finance the cost of development and construction of the Port of the Americas. The aggregate unpaid principal balance of all outstanding bond principal advances shall be payable in full on January 1, 2015. The principal amount may be paid with any of the following: a long-term bond issuance once the projects is completed, other revenue of the Port of the Americas Authority or legislative appropriations as established in Act 409 of September 22, 2004 (Act No. 409). Principal and interests payments are guaranteed by the Commonwealth of Puerto Rico by Act No. 409. As of June 30, 2006, the principal outstanding under those bond purchase agreements amounted to \$23.8 million.

**COMMONWEALTH OF PUERTO RICO**

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**(b) *Appropriation Debt***

At June 30, 2006, the outstanding balances of debt payable by Commonwealth appropriations, which are included in the individual financial statements of the following discretely presented component units, are as follows (expressed in thousands):

Puerto Rico Aqueduct and Sewer Authority	\$	1,213,449
Special Communities Perpetual Trust		425,107
Puerto Rico Land Administration		163,335
Puerto Rico Convention Center District Authority		154,846
Puerto Rico Tourism Company		126,527
Puerto Rico Housing Finance Authority (as a blended component unit of GDB)		119,489
Puerto Rico Solid Waste Authority		97,127
Agricultural Services and Development Administration		62,578
Puerto Rico Industrial Development Company		43,403
Puerto Rico Electric Power Authority		41,708
Institute of Puerto Rican Culture		21,341
Puerto Rico Infrastructure Financing Authority		14,743
Government Development Bank for Puerto Rico		10,244
University of Puerto Rico		8,212
National Parks Company of Puerto Rico		6,831
Other Governmental entities		3,473
Total	\$	<u><u>2,512,413</u></u>

# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

### (16) Conduit Debt Obligations and No-Commitment Debt

From time to time, certain of the Commonwealth's component units issue revenue bonds to provide financial assistance to private-sector entities for the acquisition and construction of transportation, environmental, industrial, tourism, educational, and commercial facilities, deemed to be in the public interest and that are expected to provide benefits to Puerto Rico. These bonds are secured by the property financed and are payable solely from payments received on the underlying mortgage loans. Upon repayment of the bonds, ownership of the acquired facilities is retained by the private-sector entity served by the bond issuance. Neither the Commonwealth nor any political subdivision or component unit thereof is obligated in any manner for the repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the basic financial statements of the issuing entities. As of June 30, 2006, conduit debt obligations consisted of the following bonds issued by component units (expressed in thousands):

Issuing entity	Issued since inception to date	Amount outstanding
Discretely presented component units:		
Puerto Rico Ports Authority	\$ 155,410	155,410
Puerto Rico Highway and Transportation Authority	\$ 270,000	155,369
Government Development Bank for Puerto Rico	\$ 663,000	641,000
Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	\$ 5,973,000	1,677,000

#### (a) *Puerto Rico Ports Authority (PRPA)*

PRPA issued Special Facilities Revenue Bonds under the provisions of two trust agreements between PRPA and a private bank. The proceeds from the sale of the bonds were used to finance the construction, acquisition of equipment, and improvement of certain facilities at Luis Munoz Marin International Airport, for the benefit of a major private airline. The property is owned by PRPA and leased to the private company. Pursuant to the agreements between PRPA and the private company, the bonds will be paid from the rent collected from the airline in amounts sufficient to pay principal, premium (if any), and interest on the bonds. The airline has guaranteed these payments.

#### (b) *Puerto Rico Highways and Transportation Authority (PRHTA)*

In March 1992, PRHTA issued Special Facility Revenue Bonds for approximately \$117 million for the construction of a toll bridge. The proceeds from the sale of these bonds were transferred by PRHTA to a private entity, Autopistas de Puerto Rico (Autopistas), pursuant to a signed agreement for the construction, transfer, and operation of the bridge. On October 2003, the PRHTA issued Special Facility Revenue Refunding Bonds, 2004 Series A amounting to approximately \$153 million for the purpose of refunding the Authority's Special Facility Revenue Bonds, 1992 Series A, B, and C, which were issued to fund the construction of the Bridge, and to pay the cost of issuance of the bonds. The bonds shall be paid from the proceeds received by Autopistas from the operation of the bridge.

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Under certain circumstances, the concession agreement may be terminated and the Authority is then obligated to assume all of the Autopista's obligation to pay principal of and interest, which pursuant to the signed agreement will be paid from the net revenues of the use and operation of the Bridge. The Authority does not currently expect the concession agreement to terminate. The outstanding bonds (including accrued interest) at June 30, 2006 amounted to approximately \$155.4 million.

**(c) GDB**

The GDB, through its Housing Finance Authority, issued \$663 million in Capital Fund Program Bonds Series 2003 to Fund PHA in its financing of improvements to various public low and moderate-income housing projects. Certain of the obligations issued are considered no-commitment debt and are excluded, along with the related assets held in trust, from the accompanying basic financial statements. These bonds are limited obligations of the Housing Finance Authority, which will be paid solely from an annual allocation of Public housing capital funds when received from the U.S. Department of Housing and Urban Development, accordingly, these bonds are considered no-commitment debt. The outstanding balance of these bonds amounted to \$641 million at June 30, 2006.

**(d) AFICA**

The revenue bonds of AFICA are used to finance facilities for environmental control, development of industrial and commercial companies, tourism projects, hospitals, and educational facilities. Pursuant to the loan agreements, the proceeds from the sales were borrowed by corporations and partnerships operating in Puerto Rico. The bonds are limited obligations of AFICA and, except to the extent payable from bond proceeds and investment thereof, will be payable solely from and secured by a pledge and assignment of the amounts payable under the loan agreements between AFICA and each borrower. Furthermore, payment of the principal and interest on the revenue bonds is unconditionally guaranteed by each of the borrowers, their parent companies, or letters of credit from major U.S. banks or U.S. branches of international banks.

**(17) Risk Management**

The risk management program of the Commonwealth and most of its discretely component units are described in note 1(y). The following describes the risk management programs separately administered by certain discretely presented component units.

**(a) UPR**

The UPR is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The UPR carries commercial insurance for these risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Under Act No. 98 of August 24, 1994, the responsibility of UPR on medical malpractice claims is limited to a maximum amount of \$75,000 per person, or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Self-insured risks liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been

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incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claim liabilities does not necessarily result in an exact amount. Claim liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

Changes in the claim liabilities amount for the two most recent fiscal years were as follows (expressed in thousands):

	<u>2006</u>	<u>2005</u>
Claims payable at beginning of year	\$ 20,260	13,598
Incurred claims and changes in estimates	27,378	27,299
Net payments for claims and adjustment expenses	<u>(29,306)</u>	<u>(20,637)</u>
Claims payable at end of year	<u>\$ 18,332</u>	<u>20,260</u>

Claims payable are reported as accounts payable and accrued liabilities in the accompanying statement of net assets.

**(b) PREPA**

PREPA is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. PREPA obtains insurance policies covering all-risk property (excluding transmission and distribution lines), boiler and machinery, and public liability. The all-risk property and boiler and machinery policies have a combined coverage of \$650 million per occurrence. The policies' self-retention in case of earthquake and windstorm losses is \$25 million and \$2 million for all other covered risks. The public general liability policy covers property damage and bodily injury to third parties with a \$75 million aggregate limit in excess of the self-retention limit of a \$1 million occurrence.

In addition, PREPA is self-insured for damage to its transmission and distribution lines. Transmission and distribution lines amounted to approximately \$3.4 billion at June 30, 2006. PREPA's self-insurance fund provides for its self-insurance risk. This fund represents principally net assets and restricted assets set aside for self-insurance amounting to approximately \$65.1 million as of June 30, 2006.

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PREPA has a cost plus health insurance program covering substantially all its employees. PREPA contracted an administrator for the processing, approval, and payment of claims at cost plus an administrative fee. The accrual includes claims processed and an estimate for claims incurred but not reported. Changes in the balances of the health insurance program and other self-insurance risks for the two most recent fiscal years were as follows (expressed in thousands):

	2006	2005
Claims payable at beginning of year	\$ 32,603	31,640
Incurred claims	130,755	127,207
Claim payments	(119,306)	(126,244)
Claims payable at end of year	\$ 44,052	32,603

Claims payable is reported as accounts payable and accrued liabilities in the accompanying statement of net assets.

(c) **PRASA**

PRASA is exposed to various risk losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Under the property insurance program, PRASA has \$300 million blanket insurance on all real and personal property. The deductible for windstorm and flood is 2%, and 5% for earthquake with a maximum amount of \$7.5 million and \$3 million for flood. For property in transit, the deductible is \$150,000 per occurrence. This policy has a general limit of \$10 million per occurrence.

The comprehensive general liability and automobile liability have basic limits of \$2 million and the umbrella is \$20 million in excess of \$3 million, per occurrence. Also, there is an excess of loss coverage of \$45 million for losses in excess of \$28 million. In the past three years, PRASA has not settled claims in excess of insurance coverage.



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**(d) SIFC**

SIFC provides workers' compensation insurance to public and private employees. This insurance covers workers against injuries, disability, or death because of work or employment-related accidents, or because illness is suffered as a consequence of their employment. SIFC establishes liabilities for estimated incurred but unpaid benefits and benefit adjustment expenses based on the ultimate cost of settling the benefits. The following table provides a reconciliation of the beginning and ending liability for incurred but unpaid benefits and benefit adjustment expenses for the two most recent fiscal years (expressed in thousands):

	<u>2006</u>	<u>2005</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	\$ 733,762	772,827
Total incurred benefits	380,629	403,866
Total benefit payments	<u>(417,469)</u>	<u>(442,931)</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at end of year	<u>\$ 696,922</u>	<u>733,762</u>

The liability for incurred but unpaid benefits and benefit adjustment expenses is reported as liabilities for automobile accident insurance and workmen compensation claims in the accompanying statement of net assets.

The liability for compensation benefits is based on historical claims experience data, assumptions and projections as to future events, including claims frequency, severity, persistency, and inflationary trends determined by an independent actuary. The actuarial study also included estimates for medical benefits, benefit adjustment expenses, and reimbursement of premiums. The assumptions used in estimating and establishing the liabilities are reviewed annually based on current circumstances and any adjustments resulting thereof are reflected in operations in the current period.

**(e) AACA**

AACA operates a system of compulsory insurance for vehicles licensed to be used on public roads and highways in Puerto Rico. This insurance covers death and bodily injuries caused by automobile accidents. The annual premium is \$35 per motor vehicle.

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The following table provides a reconciliation of the beginning and ending liability for the future benefits for the two most recent fiscal years (expressed in thousands):

	<u>2006</u>	<u>2005</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at beginning of year	\$ 107,817	109,845
Total incurred benefits	64,835	58,524
Total benefit payments	<u>(58,264)</u>	<u>(60,552)</u>
Liability for incurred but unpaid benefits and benefit adjustment expenses at end of year	<u>\$ 114,388</u>	<u>107,817</u>

The liability for future benefits is reported as liability for automobile accident insurance and workmen compensation claims in the accompanying statement of net assets. AACA has recorded this liability, including administrative expenses for claim processing, based on the results of actuarial reports prepared by independent actuaries, determined under two different methods. Death, funeral, disability, dismemberment, and the basic medical hospitalization liabilities were determined using a triangulation method. The extended benefits medical hospitalization reserve uses a regression methodology to predict the ultimate incurred claims for each incurred calendar quarter. Additionally, assumptions are made about the mortality rates of the extended benefit claimants, recognizing the impact of their traumatic injuries on life span.

Changes in the ultimate liabilities for benefit payments may be required as information develops which varies from experience, provides additional data, or, in some cases, augments data, which previously were not considered sufficient for use in determining the claim liabilities.

## (18) Commitments and Contingencies

### *Primary Government*

The Commonwealth is a defendant in numerous legal proceedings pertaining to matters incidental to the performance of routine governmental operations. Under Act No. 104 of June 25, 1955, as amended, persons are authorized to sue the Commonwealth only for causes of actions set forth in said act to a maximum amount of \$75,000 or \$150,000 if it involves actions for damages to more than one person or where a single injured party is entitled to several causes of action. Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended, the Commonwealth may provide its officers and employees with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the payment of such judgments.

With respect to pending and threatened litigation, excluding the litigation mentioned in the following paragraphs, the Commonwealth reported approximately \$306 million as an amount to cover for awarded and anticipated unfavorable judgments at June 30, 2006. This amount was included as other long-term liabilities in the accompanying statement of net assets, and represents the amount estimated as probable liability or a liability with a fixed or expected due date that will require future available financial resources for its payment. The amounts claimed exceed \$9 billion; however, the ultimate liability cannot be presently

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determined. It is the opinion of management that the claims are excessive and exaggerated. Management believes that the ultimate liability in excess of amounts provided, if any, would not be significant.

The Commonwealth is also a defendant in a lawsuit filed in a local district court by an association of primary care health centers seeking to recover from the Commonwealth \$800 million of Medicaid funds retained by the Department of Health of the Commonwealth since 1997. In June 2004, the First Circuit Court of San Juan determined that the Commonwealth must return these funds. The Commonwealth appealed this decision. As of June 30, 2006, the Commonwealth accrued \$55 million for this legal contingency.

The Commonwealth is a defendant in a class action presented by parents of special education students in the areas of education and health care. In October 2006, the San Juan Court of Appeals decided in favor of the parents' request to include damage claims pursuant to the same class action case although not as a remedy in the class action per se. The court now may award damages to the members of the class action and to do so it may look at the claims by dividing them into groups or consider each case individually. This will require that the parents prove the damages suffered. The Commonwealth plans to defend vigorously each individual case. As of June 30, 2006, the Commonwealth accrued \$440 million for this legal contingency.

The Commonwealth receives financial assistance from the federal government in the form of grants and entitlements. Receipt of grants is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal law and regulations, including the expenditure of resources for eligible purposes. Substantially all grants are subject to audit under Circular A-133 of the Office of Management and Budget of the United States of America (OMB Circular A-133), all of which are performed at the individual agency level. Disallowance as a result of these audits may become liabilities of the Commonwealth. At June 30, 2006, based on an evaluation of pending federal disallowances, the Commonwealth has recorded approximately \$53 million as other long-term liabilities in the accompanying statement of net assets. Expenditures that are still subject to audit could be disallowed but management believes any such future disallowances would not be material to the basic financial statements.

Construction commitments at June 30, 2006, entered by PBA, amounted to approximately \$274 million. In addition, the Commonwealth's construction commitments for public housing facilities amounted to approximately \$239 million at June 30, 2006.

On November 23, 1998, a global settlement agreement (the Agreement) was entered into by and between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The Agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies are to continue making contributions in perpetuity. Pursuant to Act No. 173 of July 30, 1999, which created the Children's Trust (a blended component unit), the Commonwealth assigned and transferred to The Children's Trust all payments that the Commonwealth is entitled to receive under the Agreement. Payments received under the Agreement and recognized as revenue during the year ended June 30, 2006, amounted to approximately \$65.6 million.

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Following is a summary of estimated payments to be received by The Children's Trust through the year ending June 30, 2025 (expressed in thousands):

Year ending June 30:	
2007	\$ 92,634
2008	94,017
2009	95,624
2010	96,626
2011	97,500
2012-2016	487,500
2017-2021	487,500
2022-2025	381,106
Total	<u>\$ 1,832,507</u>

At June 30, 2006, The Children's Trust, a blended component unit of the Commonwealth, had approved commitments to provide assistance to several entities through 85 contracts with balances amounting to approximately \$104 million.

### *Discretely Presented Component Units*

In the normal course of their operations, the various component units are subject to guarantees, actions brought by third parties seeking damages or entering into commitments. Such actions are disclosed in the separately issued reports of the component units, some of which are summarized below:

#### *(a) GDB*

At June 30, 2006, GDB has financial guarantees for public entities for approximately \$125 million and for private sector of approximately \$29 million. In addition, stand by-letters of credit to public entities were approximately \$113 million and to private sector were approximately \$126 million. Commitments to extend credit to public entities were approximately \$3.5 billion and to private sector were approximately \$22 million.

GDB enters into sales of securities under agreements to repurchase. These agreements generally represent short-term debts and are presented as a liability in the statement of net assets. The securities underlying these agreements are usually held by the broker, or its agent, with whom the agreement is transacted. As of June 30, 2006, there were agreements outstanding for \$515 million and during the year the average amount outstanding was approximately \$508 million, the maximum amount outstanding at any month-end was approximately \$610 million, and the weighted average interest rate for the year and at year-end was approximately 4.01% and 4.69%, respectively.

GDB issues commercial paper in the U.S. taxable and tax-exempt commercial paper markets, the Eurodollar commercial paper market, and to corporations that have tax exemption under the Commonwealth's Industrial Incentives Act. Commercial paper represents unsecured obligations of GDB. The carrying amount of commercial paper at June 30, 2006 was approximately \$1.2 billion.

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At June 30, 2006, GDB had outstanding interest rate swap agreements with other financial institutions in the aggregate notional amounts of \$1.3 billion, having a fair value (payable position) of approximately \$39 million. GDB is exposed to credit loss in the event of nonperformance by the other parties to swap agreements. However, GDB does not anticipate nonperformance by counterparties.

On August 6, 2003, GDB initiated foreclosure on the mortgage note it holds as collateral for the guarantee on the AFICA Cayo Largo bonds. The indenture of the bonds requires the repayment of the bonds before the execution of the mortgage note. Therefore, in order to execute the mortgage note, GDB called the outstanding balance of the bonds. Said bonds amounted to \$75.6 million. Resulting from the above-mentioned foreclosure proceedings, several of the principals of the Cayo Largo Hotel development (Cayo Largo Resort Associates, Cayo Largo Hotel, and D. Group Equity Holdings) have counterclaimed by filing complaints for alleged damages and breach of contract by GDB aggregating to approximately \$210 million. In addition, United States Fidelity and Guaranty Company (the Insurer) has filed an action to obtain a declaration that it is not bound to perform under the performance and payment bond executed in connection with the constructions and development of the project. Management believes that the ultimate outcome of all the counterclaims and other actions will not be material.

**(b) PRHTA**

PRHTA has entered into a System and Test Track Turnkey Contract (STTT Contract) with Siemens Transportation Partnership Puerto Rico, S.E., Juan R. Requena y Asociados, and Alternate Concepts, Inc. for the purpose of operating and maintaining the urban train system known as "Tren Urbano". The STTT Contract became effective during 2005 upon the execution of the contract for an initial term of five years with an option by PRHTA to extend the term for an additional five years. The compensation is based on a schedule included in the master agreement which approximates \$4 million on a monthly basis. The total estimated annual operation and maintenance cost including cost of insurance and electricity for the first year of operations is approximately \$40.5 million.

During 2001, a number of contractors presented claims related to the PRHTA's Urban Train project. These contractors' claims, which are at various stages of analysis to reach a final resolution, amount to \$289 million. From this amount, \$166 million has been categorized as merited claims and most of it settled. The outstanding balance of this claim at June 30, 2006 amounted to \$3.1 million, which has been accrued in the accompanying statement of net assets.

In connection with the responsibilities of the PRHTA for mass transportation systems, the Metrobus project was developed. The project consists of bus operations in part of the San Juan metropolitan area named Metrobus I, which operations are conducted by First Transit, a private company, under an agreement of \$2.8 million, which will expire on December 31, 2006. In addition, the project consists of bus operations between Bayamón and Stop 18 named Metrobus II, which operations are conducted by the Metropolitan Bus Authority (MBA), a public corporation, under a thirty-six month agreement of \$13.5 million, which expires on December 31, 2006.

On January 28, 2004, the PRHTA amended the MBA service contract for the purpose of adding certain additional routes to the mass transportation system. This service contract amounting to \$22.1 million with a term of thirty-six months expires on December 31, 2007.



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During 1995, MBA entered into a contract agreement with the PRHTA to operate and maintain one of Metrobus' routes from Río Piedras to Old San Juan, provide service for Paratransit and maintain the transfer stations. This contract is renewable every year with an increase of 6% over the last year contract amount. The total amount of this contract is approximately \$1 million and expires on June 30, 2007.

**(c) PREPA**

In May 1998, the Municipality of Ponce filed a complaint against PREPA in the San Juan Superior Court requesting the payment by PREPA of the full contributions in lieu of taxes (CLT) and electric energy sales set aside in prior fiscal years. The complaint challenges the application of the "Net Revenues" used by PREPA in making deposits to certain funds required under the 1974 Bond Indenture Agreement and under a prior trust indenture (now terminated) for the purposes of paying costs of capital improvements. The Municipality of Ponce seeks a payment from PREPA in the amount by which the amount available to pay contributions in lieu of taxes and electric sales set aside to the Municipality of Ponce has been reduced as a result of such application. PREPA understands that the enabling act which created PREPA (the Act) provides that the contributions in lieu of taxes and electric energy sales set aside are only payable after complying with PREPA's deposit obligations under the 1974 Agreement and the prior indenture and that short falls do not carry forward as future liabilities of PREPA as described above.

On April 14, 2003, PREPA made a settlement offer consisting of a payment in cash of \$68 million and \$57 million for electric infrastructure projects in the municipalities. As part of the settlement agreement, the municipalities supported an amendment to the Act that was proposed by PREPA, that the amount payable to municipalities be calculated based on a percentage of the net revenues defined on the 1974 Bond Indenture Agreement. Prior to fiscal year 2005, 76 of the 78 municipalities of Puerto Rico had accepted the settlement receiving an aggregate amount of \$63.6 million. During fiscal year 2005, the remaining two municipalities accepted the settlement offer, receiving \$4.4 million. The settlement required PREPA to submit legislation to change the CLT calculation. The new law signed in August 2004 included a transition clause regarding the \$68 million payment, stating that this amount was a special CLT that the accepting municipalities would receive with financing provided by GDB. The debt to GDB is guaranteed with the CLT. In connection with the same litigation, GDB approved a line of credit of \$57 million, for electric infrastructure projects on municipalities. As of June 30, 2006, PREPA has drawn \$34.9 million.

In October 1994, PREPA signed a contract with AES Puerto Rico, L.P. (AES) to purchase power of approximately 454 megawatts generated from a coal fluidized bed combustion facility. The term of the agreement is for 25 years. This project commenced operations in November 2002. In March 1995, PREPA also signed a contract with EcoElectrica, L.P. (EcoElectrica) to purchase power of approximately 507 megawatts from a gas-fired combined cycle power plant. The term of the agreement is for 22 years. This project has been in operation since 2000.

In June 2004, the Office of the Comptroller of the Commonwealth of Puerto Rico issued a report stating that PREPA overcharged its clients by approximately \$49.8 million and should reimburse this amount to such clients. After this report was made public, two lawsuits were filed by customers of

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PREPA demanding the reimbursement of such alleged overcharges. PREPA denies that any overcharges have been made.

**(d) PRIFA**

The law that created PRIFA (as amended) requires that the first \$70 million up to fiscal year 2006, and the first \$90 million in each fiscal year thereafter through 2052, of federal excise taxes received by the Commonwealth be transferred to PRIFA for deposit to PRIFA's infrastructure fund (the Infrastructure Fund). Federal excise taxes consist of taxes received by the Commonwealth from the United States in connection with rum and other articles produced in Puerto Rico and sold in the United States that are subject to federal excise tax.

A related trust agreement requires PRIFA to deposit to the credit of a sinking fund the federal excise taxes and other moneys deposited to the credit of the Infrastructure Fund in such amounts as are required to meet debt service requirements with respect to the bonds. Rum is the only article currently produced in Puerto Rico subject to federal excise tax, the proceeds of which are required to be transferred from the federal government to the Commonwealth.

The federal excise taxes securing the bonds are subject to a number of factors, including the continued imposition and remittance of such taxes to the Commonwealth and conditions affecting the Puerto Rico rum industry. If the federal excise taxes received by the Commonwealth in any fiscal year are insufficient to deposit the amount required by the law into the Infrastructure Fund, the law that enacted PRIFA requires that PRIFA request and the director of the OMB include in the annual budget of the Commonwealth for the corresponding fiscal year an appropriation necessary to cover such deficiency. The Commonwealth's Legislature, however, is not legally obligated to make the necessary appropriation to cover such deficiency.

**(e) PRTA**

PRTA, through its subsidiary PRTA Holdings, holds shares of Telecomunicaciones de Puerto Rico, Inc. (TELPRI). TELPRI is the Puerto Rico corporation that was organized for the purpose of acquiring the stock of Puerto Rico Telephone Company (PRTC) and Celulares Telefonica (CT) from PRTA in connection with the sale transaction of March 2, 1999, where a subsidiary of Verizon, Popular, Inc., and TELPRI's employee stock ownership plan acquired 57% of TELPRI and completed the privatization of PRTC and CT. It is contemplated that all shares of TELPRI held by PRTA Holdings will be sold in public offerings and private placements, and all dividends and proceeds received from the sale of the shares will be distributed to the ERS. The PRTA's 43% investment in TELPRI was carried on the equity method of accounting through December 28, 2000. Although the ownership of the common stock of PRTA Holdings entitles PRTA to the voting right over TELPRI shares, no carrying value is recorded for its investment after the transfer of PRTA Holdings preferred stock to the Retirement System on December 28, 2000, since such preferred stock entitles the Retirement System to all the economic benefits of the investments in TELPRI.

Verizon delivered a notice of claim for indemnity to PRTA related to certain alleged actions of PRTA that occurred before the closing of the sale transaction described above. The amount of indemnity sought by Verizon is approximately \$105 million, related to several matters including PRTC's exposure to a potential reduction in tariffs or required rebate to clients as a result of an



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adverse decision by the Federal Communications Commission (FCC) on a regulatory matter. The FCC's decision has been appealed by PRTC and the FCC denied such request. In June 2000, PRTA requested Verizon to provide additional information that would enable it to evaluate the merit of claims made; however, the additional information has not been submitted. Additionally, in connection with the privatization, the PRTA agreed to indemnify, defend, and hold TELPRI harmless for specified litigation in excess of \$50 million in the aggregate.

Management believes that the final resolution of the legal cases will not have a material adverse effect on the financial position and results of operations of PRTA.

**(f) PCSDIPRC**

PCSDIPRC provides insurance coverage over the stocks and deposits of all the cooperatives and the Federation of Cooperatives of Puerto Rico. The deposit base of the cooperatives approximates \$5.9 billion at June 30, 2006.

**(g) LAPR**

At year-end, LAPR had approximately \$28.5 million in accruals to cover the estimated costs related to the liquidation of the Sugar Corporation of Puerto Rico, a blended component unit of LAPR, including, among others: employee severance, pending legal cases, environmental clean up costs, refinery repair costs, and estimated future losses to be incurred. Management believes these accruals to be sufficient; however, given the many uncertainties involved, the ultimate outcome cannot be determined with certainty at this time and the actual liquidation costs could be higher or lower than the estimates made. LAPR is also a defendant in various claims amounting to approximately \$161 million. LAPR is in the process of litigating such claims and the ultimate liability, if any, cannot be presently determined.

### **Fiduciary Component Unit**

ERS enters into sales of securities under agreements to repurchase. These agreements generally represent short-term debts and are presented as a liability in the statement of net assets. The securities underlying these agreements are usually held by the broker, or its agent, with whom the agreement is transacted. As of June 30, 2006, there were agreements outstanding for \$139 million and the weighted average interest rate at year-end was 5.07%.

### **Environmental Commitments and Contingencies**

The following component units' operations include activities that are subject to state and federal environmental regulations:

- **PREPA** – Facilities and operations of PREPA are subject to regulations under numerous federal and Commonwealth environmental laws, including the Clean Air Act, Clean Water Act, and the National Pollutant Discharge Elimination System (NPDES). In February 1992, the U.S. Environmental Protection Agency (EPA) performed an inspection of various facilities of PREPA and became aware of deficiencies in different areas, principally air opacity; water quality; spill prevention control and countermeasures; and underground storage tanks. As a result, PREPA agreed to, among other things,

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make certain capital improvements, undertake supplemental environment project (SEPs), and use fuel oil not exceeding certain predetermined levels of sulfur, vanadium, and asphalt in its content.

- **PRASA** – Facilities and operations of PRASA's water and sewer system are subject to regulation under numerous federal and Commonwealth environmental laws. Under agreements with the federal government, acting on behalf of EPA, PRASA and the Commonwealth are subject to consent decrees to enforce compliance with environmental laws. During the year ended June 30, 2006, noncompliance penalties amounted to \$18.4 million. In addition, PRASA has committed to perform environmental projects, in lieu of penalties, in the amount of \$120 million as of June 30, 2006.
- **PRSWA** – Is currently involved in the implementation and development of the Infrastructure Regional Plan for Recycling and Disposal of Solid Waste in Puerto Rico. As of June 30, 2006, PRSWA has no insurance coverage for environmental risks and management believes that, at this time, there is no sufficient information available to determine the potential amount of related losses, if any, and no provision for losses has been made in the PRSWA's financial statements. Nevertheless, preventive infrastructure has been constructed and operational plans have been developed to minimize any possible impact or events that could occur.
- **PRIDCO** – Financial responsibility for cleanup costs has been and/or is being undertaken by the industrial potential responsible parties (PRPs) at the two Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA) sites (Vega Alta and Guayama), where the federal government named PRIDCO as a PRP solely for being a part owner of both sites. PRIDCO's participation in the site remediation efforts to date has been limited to providing in-kind support to the industrial PRP's implementation of the cleanup programs and, consequently, has not involved any cash disbursements to the federal government or the industrial PRP groups. Under CERCLA and its regulations, liability for the cleanup costs and damage to natural resources and any assessment of health effects may be imposed on the present and past owners or operators of a facility from which there was a release of hazardous substances. In addition, any person who arranged for the disposal or treatment of hazardous substances at a site from which there was a release may also be liable.

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#### Construction Commitments

As of June 30, 2006, the following component units maintained various unspent construction agreements as follows (expressed in thousands):

Puerto Rico Highways and Transportation Authority	\$ 747,559
Special Communities Perpetual Trust	511,670
Puerto Rico Aqueduct and Sewer Authority	393,000
Puerto Rico Electric Power Authority	350,000
Puerto Rico Infrastructure Financing Authority	230,800
University of Puerto Rico	144,409
Puerto Rico Ports Authority	125,903
Puerto Rico Solid Waste	110,722
Puerto Rico Industrial Development Company	57,047
Puerto Rico Medical Service Administration	14,717
Puerto Rico Conservatory of Music Corporation	11,400
Puerto Rico Convention Center District Authority	5,733
Fine Arts Center Corporation	712
Cardiovascular Center Corporation Puerto Rico and the Caribbean	567
Institutional Trust of National Guard	149
Total	<u>\$ 2,704,388</u>

#### (19) Retirements Systems

The Commonwealth sponsors three contributory pension plans (collectively known as the Retirement Systems), which are reported in the accompanying statement of fiduciary net assets:

- Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities
- The Puerto Rico Judiciary Retirement System
- Puerto Rico System of Annuities and Pensions for Teachers

Each system is independent; thus their assets or liabilities may not be transferred from one system to another or used for any purpose other than to benefit the participants of each system.

The Retirement Systems issue financial reports, which are publicly available and include the basic financial statements, the required trend information, and any other required supplementary information. These reports may be obtained by written request to the corresponding retirement system administrator at the addresses detailed in note 1 of each retirement system's basic financial statements.

#### (a) *ERS*

##### Plan Description

The System is a cost-sharing multiemployer defined-benefit plan sponsored by the Commonwealth. ERS was created under Act No. 447 (the Act), approved on May 15, 1951, as amended, and became effective on January 1, 1952. ERS covers substantially all full-time employees of: (1) the

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Commonwealth's primary government and (2) certain municipalities of Puerto Rico and certain component units of the Commonwealth not having their own retirement systems. Appointed and temporary Commonwealth employees become plan members upon their date of employment. Plan members are eligible for a retirement annuity upon reaching the following age:

<u>Police and firemen</u>	<u>Other employees</u>
50 with 25 years of credited services	55 with 25 years of credited services
58 with 10 years of credited services	58 with 10 years of credited services

Plan members are eligible for merit annuity with a minimum of 30 years or more of credited service.

On the coordinated plan, a participating employee contributes 5.775% of the monthly salary for the first \$550 and 8.275% for the excess over \$550. By the time the employee reaches 65 years of age and begins to receive Social Security benefits, the pension benefits are reduced by the following:

- \$165 per month if retired with 55 years of age and 30 years of credited service
- \$110 per month if retired with less than 55 years of age and 30 years of credited service
- All other between \$82 and \$100 per month
- Disability annuities under the coordinated plan are also adjusted at age 65 and in some cases are reduced over \$165 per month.

On the noncoordinated plan, the participating employee contributes 8.275% of the monthly salary and does not have any change on the pension benefits upon receipt of Social Security benefits.

Death benefits are divided into occupational, nonoccupational, and postretirement. Under the occupational benefits, a surviving spouse may receive an annuity equal to 50% of the participating employee's salary at the date of death and each child may receive \$10 per month for minor, or student, up to a maximum benefit per family of 100% of the participating employee's salary at the date of death. If no spouse survives, or dies while receiving the annuity payments, each child, 18 or under, is eligible to receive an annuity of \$20 per month up to the attainment of 18 years of age or the completion of his/her studies. Under the nonoccupational benefits, the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of death are paid. Under the postretirement benefit, the beneficiary with a surviving spouse and child 18 or under receive up to 50% (60%, if not covered under Title II of the Social Security Act) of the retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$750.

On September 24, 1999, an amendment to the Act, which created ERS, was enacted to establish a defined-contribution plan known as System 2000.

System 2000 became effective on January 1, 2000. Employees participating in the defined-benefit plan system at December 31, 1999, had the option to either stay in the defined-benefit plan or transfer to System 2000. Persons employed on or after January 1, 2000, are only allowed to become members of System 2000.

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System 2000 is a hybrid defined-contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of plan assets, which will be invested by ERS, together with those of the defined-benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on a formula which assumes that each year the participants' contributions (with a minimum of 8.275% of the participants' salary up to a maximum of 10%) will be invested as instructed by the participant in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Notes; (2) earn a rate equal to 75% of the return of ERS's investment portfolio (net of management fees); or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined-contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The sponsors' contributions (9.275% of the participants' salary) will be used to fund the defined benefit plan.

System 2000 reduces the retirement age from 65 years to 60 for those employees who joined the original plan on or after January 1, 2000.

#### **Funding Policy**

Contribution requirements, which are established by law and are not actuarially determined, are as follows:

Commonwealth and other sponsors	9.275% of applicable payroll
Participants:	
Hired on or before March 31, 1990	5.775% of monthly gross salary up to \$550 8.275% of monthly gross salary in excess of \$550
Hired on or after April 1, 1990	8.275% of monthly gross salary

#### **(b) JRS**

##### **Plan Description**

The JRS is a single-employer defined-benefit plan, which is also administered by the ERS. The system was created under Act No. 12, approved on October 19, 1954. Membership is made up of all judges of the Judiciary Branch of the Commonwealth.

The system provides retirement as well as death and disability benefits. Benefits vest after 10 years of service and upon reaching 60 years of age.

Retirement benefits are determined by the application of stipulated benefit ratios to the plan member's average compensation. Average compensation is computed based on the last month of compensation.

The retirement annuity, for which the plan participant is eligible, is limited to a minimum of 25% and a maximum of 75% of the average compensation, except for judges of the Supreme Court for whom the annuity is limited to a minimum of 50% and a maximum of 100% of the average compensation.

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Death benefits are divided into occupational, nonoccupational, and postretirement. Under the occupational benefits, a surviving spouse may receive an annuity equal to 50% of the participating employee's salary at the date of death and each child may receive \$10 per month for each child, minor, or student, up to a maximum benefit per family of 75% of the participating employee's salary at the date of death. If no spouse survives or dies while receiving the annuity payments, each child, 18 or under, is eligible to receive an annuity of \$20 per month up to the attainment of 18 years of age or the completion of his/her studies. Under the nonoccupational benefits, the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of death is paid. Under the postretirement benefit, the beneficiary with surviving spouse age 60 or over and child 21 or under receive up to 60% of the retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of \$500.

During 1997, JRS enacted Act No. 177 which provides, effective January 1, 1999, for increases of 3%, every three years, of the pension benefits paid by JRS to those plan participants with three or more years of retirement.

#### **Funding Policy**

All participants are required to make contributions to the plan equal to 8% of the applicable payroll. The Commonwealth, as sponsor, must contribute 20% of the applicable payroll. Contributions are established by law and are not actuarially determined.

#### **(c) TRS**

##### **Plan Description**

The TRS is a single-employer defined-benefit plan sponsored by the Commonwealth. All active teachers of the Department of Education of the Commonwealth are covered by the system under the terms of Act No. 91 of March 29, 2004 that superseded Act No. 218 of 1951. Licensed teachers working in private schools may also participate in the system as long as the required employer and employee contributions are satisfied.

The plan provides retirement, death, and disability benefits. Benefits vest after completion of a given number of years of credited service based on age. Benefits are determined by the application of stipulated benefit ratios to the members' average compensation. Average compensation is computed based on the highest three years of compensation recognized by TRS.

The annuity for which a plan member is eligible is limited to a minimum of \$300 per month and a maximum of 75% of the average compensation.

##### **Funding Policy**

Effective January 27, 2000, participant contributions were increased to 9% of their compensation, as provided by Act No. 45 of 2000. The Commonwealth, as sponsor, matches the participants' contributions at a rate of 8.5% of the applicable payroll. Contribution rates are established by law and are not actuarially determined.



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Other relevant information on the Commonwealth's Retirement Systems is presented below (as of July 1, 2005, for JRS and ERS, and July 1, 2004 for TRS, for latest valuation date):

***Membership***

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>	<u>Total</u>
Retirees and beneficiaries currently receiving benefits	\$ 88,333	367	27,944	116,644
Current employees	177,054	370	51,026	228,450
Total	<u>\$ 265,387</u>	<u>737</u>	<u>78,970</u>	<u>345,094</u>

***Annual Pension Cost and Net Pension Obligation (Asset)***

The Commonwealth's annual pension cost and net pension obligation (asset) of the three pension plans for the year ended June 30, 2006, were as follows (expressed in thousands):

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>	<u>Total</u>
Annual required contributions	\$ 564,218	9,735	220,821	794,774
Interest on net pension obligation (asset)	332,802	(859)	40,037	371,980
Adjustment to annual required sponsors' contributions	<u>(262,137)</u>	<u>677</u>	<u>(39,409)</u>	<u>(300,869)</u>
Annual pension cost	634,883	9,553	221,449	865,885
Statutory sponsors' contributions made	<u>(415,056)</u>	<u>(6,727)</u>	<u>(180,265)</u>	<u>(602,048)</u>
Increase in net pension obligation	219,827	2,826	41,184	263,837
Net pension obligation (asset) at beginning of year	<u>3,915,316</u>	<u>(10,111)</u>	<u>564,479</u>	<u>4,469,684</u>
Net pension obligation (asset) at end of year	<u>\$ 4,135,143</u>	<u>(7,285)</u>	<u>605,663</u>	<u>4,733,521</u>

The net pension obligation for ERS and TRS, and the net pension asset of JRS of \$4,741 million and \$7 million, respectively, are recorded in the accompanying statement of net assets.



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The annual required contribution was determined by actuarial valuations for each of the pension plans as described below:

	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>
Date of latest actuarial valuation	July 1, 2005	July 1, 2005	July 1, 2004
Actuarial-cost method	Projected unit credit cost	Projected unit credit cost	Entry age normal
Amortization method	Level percentage of the projected payroll	Level percentage of the projected payroll	Level percentage closed 5% payroll increase per year
Remaining amortization period	21 years	21 years	16 years
Amortization approach	Closed	Closed	Closed
	<u>ERS</u>	<u>JRS</u>	<u>TRS</u>
Asset-valuation method	Market value	Market value	Market value
Actuarial assumptions:			
Inflation	3.5%	3.5%	3.5%
Investment rate of return	8.5	8.5	8.5
Projected salary increases per annum	5.0	5.0	5.0
Cost-of-living adjustments	None	None	None

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### Three-Year Trend Information

The three-year trend information is as follows (expressed in thousands):

		ERS	JRS	TRS
Annual pension cost (APC):				
Year ended June 30, 2006	\$	634,882	9,553	221,449
Year ended June 30, 2005		652,252	8,380	221,449
Year ended June 30, 2004		652,252	8,380	219,168
Percentage of APC contributed:				
Year ended June 30, 2006		65.0%	70.0%	81.0%
Year ended June 30, 2005		60.0	77.0	82.0
Year ended June 30, 2004		53.0	66.0	69.00
Net pension obligation (asset):				
Year ended June 30, 2006	\$	4,135,141	(7,285)	605,663
Year ended June 30, 2005		3,915,315	(10,111)	564,480
Year ended June 30, 2004		3,652,617	(12,021)	524,770

### Schedule of Funding Progress (Required Supplementary Information – Unaudited)

Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (expressed in thousands):

Actuarial valuation date	Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
July 1, 2005	\$ 2,327,871	12,283,865	9,955,994	19%	\$ 4,125,866	241%
July 1, 2004	2,141,442	N/A	N/A	N/A	N/A	N/A
July 1, 2003	1,947,402	11,191,357	9,243,955	17	3,334,441	277

The Puerto Rico Judiciary Retirement System (expressed in thousands):

Actuarial valuation date	Actuarial value of assets	AAL	UAAL	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
July 1, 2005	\$ 69,797	174,454	104,657	40%	\$ 29,331	357%
July 1, 2004	67,851	N/A	N/A	N/A	N/A	N/A
July 1, 2003	61,781	166,732	104,951	37	25,711	408

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Puerto Rico System of Annuities and Pensions for Teachers (expressed in thousands):

Actuarial valuation date	Actuarial value of assets	AAL	UAAL	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
July 1, 2004	\$ 2,403,000	4,702,000	2,299,000	51%	\$ 1,294,000	178%
July 1, 2003	2,143,000	4,540,000	2,397,000	47	1,195,000	201
July 1, 2002	2,167,000	4,155,000	1,988,000	52	991,000	201

On August 12, 2000, Act No. 174 was approved to allow certain ERS participants to be eligible for early retirement upon attaining at least age 55 with 25 years of service, provided they made their election on or before April 1, 2001. Those who elected early retirement under this law will receive monthly benefits of 75% (if 25 or more years of service and age 55, or 30 or more years of service and age 50) or benefits of 65% (if 25 years of service by less than age 55) of their average compensation which is computed based on the highest 36 months of compensation recognized by ERS. In these cases, the sponsor is responsible for contributing to ERS amounts to cover the benefit payments and the sponsor contribution with respect to the participants covered until the participants reach the normal retirement age.

## (20) Subsequent Events

### *Primary Government*

In an effort to address the Commonwealth's structural budget imbalance, the Legislature enacted Act No. 117 of July 4, 2006 (Act 117), which amended the Puerto Rico Internal Revenue Code of 1994 to provide, among other things, for a general sales and use tax of 5.5% (the Sales Tax) to be imposed by the Commonwealth. The Act also eliminated the 5% general excise tax imposed on imported goods and the 3.6% general excise tax on goods manufactured in Puerto Rico, and provides certain income tax reductions to taxpayers. The Sales Tax went into effect on November 15, 2006. Act 117 also imposes other measures to address the structural budget imbalance, such as fiscal reform, government reorganization plan, and special income tax rates to certain transactions occurring during the first semester of fiscal year 2007.

In addition, on December 26, 2006 and July 6, 2007, Acts 291 and 56 were enacted to amend Act 91 of May 13, 2006 to create, among other things the Puerto Rico Sales Tax Financing Corporation known by its Spanish acronym "COFINA". This newly created component unit of GDB will have the capacity to issue bonds or other mechanisms to repay or refinance Commonwealth debt obligations payable to GDB with Commonwealth budgetary appropriations referred as extra-constitutional debt. Act 91 also created the Dedicated Sales Tax Fund known by its Spanish acronym FIA Fund, as a separate fund to be administered by GDB. The FIA Fund will generate revenues from collections of the first one percent of the sales tax or a minimum amount, as the defined by law, whichever is greater. Such revenues shall be used for, among other things, paying, refinancing, or restructuring the extra-constitutional debt of the Commonwealth that was outstanding at June 30, 2006. COFINA will administer the FIA Fund and will use the collections of the sales tax to repay or refinance the Commonwealth's extra-constitutional debt, including amounts due GDB and any obligations issued under any financing arrangement.

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On September 8, 2006, PBA executed a loan agreement with GDB for interim financing of its capital improvement program in an amount not to exceed \$223.6 million, bearing interest at 1.5% over the cost of the tax-exempt commercial paper issued by GDB

The board of directors of PBA decided to enter into two Swap transactions in order to fix the interest rates on bonds Series J and K to eliminate the risk of increase in interest rates. On August 8, 2006, the PBA entered into the first Swap transaction with the Bank of New York in the notional amounts of the \$89 million. The transaction's effective date and termination date is July 2027. The interest rate is a fixed rate of 3.77310%. On September 8, 2006, the PBA entered into another Swap transaction with the Royal Bank of Canada. The notional amount of this transaction was \$150 million, with a termination date of July 1, 2006 and a final rate of 3.63907%.

On May 22, 2007, Standard & Poor's Ratings Services lowered its long-term rating on the Commonwealth of Puerto Rico's General Obligation (GO) debt one notch to 'BBB-' from 'BBB', reflecting a long history of structural imbalance and the ongoing difficulties anticipated with further efforts to reduce the accrued deficit. The outlook is stable. Standard & Poor's noted that Puerto Rico's debt, which is already high, is likely to increase. Although a major new revenue source--a 5.5% sales tax--was added in the current fiscal year, balance remains difficult to achieve, requiring expense cuts and use of one-time revenue sources. Gap forecasts suggest that balance will not be achieved until 2010 and those forecasts are based on the expectation of flat expense growth.

#### *Component Units*

##### *(a) GDB*

Subsequent to June 30, 2006, the Public Finance Corporation, as a blended component unit of GDB, disbursed approximately \$303 million to pay the fiscal year 2007 debt service of its no-commitment debt on behalf of the Commonwealth. On October 4, 2006, the Department of Treasury and GDB, as administrator of the Dedicated Sales Tax Fund (known by its Spanish acronym as FIA Fund), entered into a memorandum of understanding whereby the FIA Fund agrees that the payment of principal of and interest on this advance will be paid from collections received by the FIA Fund.

On August 23, 2006, the Housing Finance Authority, another blended component unit of GDB, issued Mortgage-Backed Certificates, 2006 series A (the Certificates) amounting to \$166 million. The Certificates are collateralized by certain GNMA and FNMA certificates and mature at various dates through 2030. Proceeds from issuance of the Certificates will be used for the defeasance of certain outstanding debt of the Housing Finance Authority, to fund escrow accounts and reserves for the payment of principal and interest of Certificates, for the payment of related costs of issuance, bond defeasance costs and other expenses, and for general business purposes.

Standard & Poor's lower the GDB rating of 'BBB/A-2' to 'BBB-/A-3' (see more below).

As previously disclosed, on December 26, 2006 and July 6, 2007, Acts 291 and 56 were enacted to amend Act 91 which created, the Puerto Rico Sales Tax Financing Corporation (PRSTFC). The PRSTFC is a newly-created component unit of GDB created by Act 91 for the purpose of financing the payment, retirement or defeasance of the extra-constitutional debt outstanding as of June 30, 2006. Act 91 vested the PRSTFC with all the powers conferred on GDB under its charter (other than

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

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the power to act as fiscal agent), including the power to issue bonds for its corporate purposes, to the extent required in order for the PRSTFC to carry out the purpose for which was created. The PRSTFC is also known by its acronym in Spanish "COFINA". Act 91 provides that present and future collections of the pledge sales tax be transferred to the FIA Fund to pay, all or part of the extra-constitutional debt outstanding as of June 30, 2006 with the net proceeds of the bonds issued by PRSTFC and with other funds and resources available to the PRSTFC. Act 91 provides that the board of directors of PRSTFC shall consist of the members of the board of directors of GDB.

On July 17, 2007 the PRSTFC issued \$2.6 billion Sales Tax Revenue Bonds Series 2007 A and \$1.3 billion Sales Tax Revenue Bonds Series 2007 B to provide funds to the Commonwealth to be applied to the repayment of certain of its debt obligations owed to GDB.

**(b) UPR**

On December 13, 2006, the UPR issued \$547 million in bonds payable, consisting of Series P for \$286 million and Series Q for \$260 million. The proceeds from Series P were used principally for the refinancing of portions of previously issued Series M and Series O. The proceeds of Series Q were used principally for the payment of an amount owed on the line of credit with GDB and provided funds to the capital improvement program of the UPR.

The rating on the University of Puerto Rico (UPR) system revenue bonds has been lowered to 'BBB-' from 'BBB'. The outlook is stable. The downgrade reflects the lower rating on the Commonwealth's GO debt and UPR's high and increasing dependence upon the Commonwealth for its revenues. Under Commonwealth Act 2 of 1966, UPR is allocated an amount equal to 9.6% of the average total revenue collected by the Commonwealth during the prior two fiscal years. Appropriations account for about 90% of UPR's operating budget and in fiscal 2006 appropriations from the Commonwealth were \$812.6 million, or nearly \$13,000 per student.

**(c) PRHTA**

Subsequent to June 30, 2006, PRHTA made an agreement with a commercial bank in which the PRHTA may borrow up to \$400 million in a revolving line of credit. The proceeds from the loan will be used to finance the PRHTA's capital improvement program and to repay the amount due to GDB under the line of credit agreement.

The ratings for the Puerto Rico Ports Authority (A-/Stable) and Puerto Rico Highways and Transportation Authority's highway revenue bonds (A-/Stable), transportation revenue bonds (BBB+/Stable), subordinate transportation revenue bonds (BBB/Stable), and special facility revenue refunding bonds, 2003 series A (BBB-/Stable) will not change, despite the lowering of the Commonwealth's rating. Standard & Poor's considers pledged revenues for these credits as fairly insulated. However, further deterioration in the Commonwealth's credit quality could be a rating concern for these transportation credits.

**(d) PREPA**

On July 20, 2006, PREPA and JP Morgan Chase Bank National Association, as Administrative Agent and Issuing Bank, entered into an agreement for a revolving line of credit of \$100 million to be used for operational purposes.

## COMMONWEALTH OF PUERTO RICO

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On September 13, 2006, PREPA and Citibank, N.A., as Administrative Agent, entered into an agreement for a revolving line of credit of \$400 million to be used for interim financing of a portion of the cost of various projects under its Capital Improvement Program.

On December 22, 2006, PREPA and a syndicate of banks lead by Banco Popular de Puerto Rico, as Administrative Agent, entered into an agreement for a line of credit of \$200 million to be used to refund prior lines of credit in use by PREPA. In addition, on that date, PREPA also entered into an eight year annual installment loan agreement with the same syndicate to refinance the outstanding balance of \$64 million.

On May 3, 2007, PREPA issued \$644 million Power Revenue Bonds, Series TT and \$1 billion Power Revenue Refunding Bonds, Series UU. The refunding will allow PREPA to realize savings on its debt service requirements on bonds outstanding under the 1974 Agreement.

On May 30, 2007, PREPA issued \$557 million Power Revenue Refunding Bonds, Series VV. The refunding will allow PREPA to realize savings on its debt service requirements on bonds outstanding under the 1974 Agreement.

**(e) PRASA**

On September 8, 2006, PRASA entered into \$250 million term loan agreement with various banks. The proceeds were used to repay various lines of credit with GDB and pay costs and fees associated with the term loan.

On December 22, 2006, PRASA entered into a \$850 million bond anticipation note agreement with a commercial bank. The proceeds were used to repair various line of credits with GDB and fees associated with the anticipation note.

On January 9, 2007, PRASA entered into a Final Settlement Agreement in which PRASA and Ondeo agreed that PRASA will assume the outstanding claims that have not been resolved as of that date, which include unpaid invoices and legal, environmental, and labor claims that arose during the Service Agreement and Transition Service Agreement period.

PRASA experienced a significant reduction in the financial assistance from the government during the year ended on June 30, 2006. To mitigate the effect of such information or reduction in the financial report, PRASA has implemented a gradual increase process in the water and sewer rates.

**(f) PRIFA**

On September 19, 2006, the PRIFA issued \$470 million Special Tax Revenue Bonds, Series 2006, for the purpose of developing the infrastructure necessary for the XXI Central American and Caribbean Games (the Games) to be held in 2010. The proceeds of this issuance will provide for (1) the acquisition, improvements, and construction of sports and other facilities necessary for the Games; (2) the construction of certain capital projects of the Commonwealth instrumentalities and municipalities; and (3) the payment of capitalized interest and cost of issuance of the Series 2006 Bonds. The Series 2006 Bonds were deposited into a Special Construction Fund administered by PRIFA on behalf the applicable benefited entities. The Series 2006 Bonds bear interest at various rates ranging from 4.25% to 5.00% maturing on various dates from July 1, 2010 to July 1, 2046.



## COMMONWEALTH OF PUERTO RICO

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Interest is payable semiannually on January 1 and July 1 of each year commencing January 1, 2007. Bonds are secured by a pledge of federal excise taxes and other monies deposited to the credit of the sinking fund.

**(g) PRHIA**

On November 19, 2006, the Governor of the Commonwealth signed the Act No. 249 which creates the Special Workers Health Fund (SWHF). The SWHF is financed by a loan of \$253 million from GDB. The loan is guaranteed and will be paid by the State Insurance Fund Corporation (SIF). This act assigns to the PRHIA the amount of \$203 million of the SWHF for the fiscal year 2006-2007 for the payment of premiums of the health insurance system. The SIF loan repayment will be funded through annual legislative appropriation.

**(21) Debt Service Deposit Agreements**

On May 26, 2005 (but effective on July 1, 2005), the Commonwealth, PFC, and GDB (together the Commonwealth) and Lehman Brothers Special Financing Inc. (Lehman) entered into Debt Service Deposit Agreements (DSD Agreements), the objective of which was for the Commonwealth to secure an upfront payment in exchange for granting Lehman the rights to earnings generated from eight of its debt service funds. Seven of the funds are associated with the Commonwealth's PFC bonds, presented in the accompanying basic financial statements as Commonwealth appropriation bonds, and one fund is associated with the Commonwealth's general obligation bonds. The upfront payment, which amounted to \$82.7 million, was received on May 26, 2005 and equaled the present value of the projected earnings income adjusted for credit timing risks as well as an appropriate amount of compensation for Lehman.

With the upfront payment made as explained above, the Commonwealth will now deliver to Lehman the required and scheduled debt service deposits and Lehman will deliver qualified government debentures which will mature before the next debt service payment date at an amount approximating such next debt service payment. Lehman will attempt to earn sufficient funds on the debt service deposit amounts, less their cost for the qualified government debentures, to make back the \$82.7 million over time. At the same time, the Commonwealth will be managing its borrowings and investments by increasing the predictability of its cash flows from earnings on its investments and not for purpose of speculation. The Commonwealth acknowledges that in exchange for the upfront payment received, it is foregoing its right to receive investment earnings on the deposit amounts referred to above in the future and that by accepting the upfront payment, the Commonwealth has minimized the risks resulting from fluctuations in interest rates during the term of the DSD Agreements but also has foregone the possibility of receiving greater returns on such amounts from such fluctuations.

Under the DSD Agreements, the Commonwealth will be exposed to the payment to Lehman of a Termination Amount, as defined in the agreement, principally upon the occurrence of redemption or a defeasance of the related bonds on or prior to the last scheduled deposit date. The amount of the Termination Amount will vary depending on various market conditions, as defined in the DSD Agreements. Under certain market conditions, the Termination Amount owed to Lehman by the Commonwealth may exceed the amount of the original upfront payment received.

The \$82.7 million upfront payment received by the Commonwealth was recognized as other revenue for budgetary purposes in 2005; however, under generally accepted accounting principles, such upfront



# COMMONWEALTH OF PUERTO RICO

## Notes to Basic Financial Statements

June 30, 2006

payment was deferred and is being recognized proportionally over the future periods the Commonwealth would have otherwise earned such interest earnings. As the effective date of DSD Agreements was July 1, 2005, all of the \$82.7 million upfront payment received in 2005 had been recorded as deferred revenue. During fiscal year 2006, approximately \$5.8 million was amortized into other revenue in the accompanying statement of revenue, expenditures, and changes in fund balance of the general fund.

### (22) Derivatives

At of June 30, 2006 the Commonwealth was party to the following interest-rate swap agreements (notional amount and fair value in thousands).

Date	Notional amount	Floating rate indicator (pays)	June 30, 2006				Maturity date	Fair value June 30, 2006
			Receives		Pays			
			Type	Rate	Type	Rate		
April 13, 2004	\$ 55,925	LIBOR	Fixed	3.3080%	Variable	3.4403%	May 27, 2021	\$ 1,257
April 13, 2004	56,000	LIBOR	Fixed	3.5820	Variable	3.4403%	June 27, 2024	443
April 13, 2004	56,000	LIBOR	Fixed	3.5590	Variable	3.3569	June 29, 2027	(459)
April 13, 2004	55,975	LIBOR	Fixed	3.5750	Variable	3.3535	June 29, 2028	(544)
April 13, 2004	19,290	LIBOR	Fixed	3.5700	Variable	3.3303	June 29, 2029	(170)
April 13, 2004	30,710	LIBOR	Fixed	3.5700	Variable	3.3535	June 29, 2029	(273)
April 13, 2004	50,000	LIBOR	Fixed	3.5730	Variable	3.3590	June 29, 2029	(464)
April 13, 2004	61,975	LIBOR	Fixed	3.5740	Variable	3.3568	June 29, 2029	(551)
April 13, 2004	62,000	LIBOR	Fixed	3.5090	Variable	3.3034	June 29, 2029	(380)
June 21, 2006	1,273,778	3 m LIBOR	3 m LIBOR X .67	3.0820	BMA	3.9700	July 1, 2035	(18,916)
		BMA	Fixed	0.0441				(6,305)
	\$ 1,721,653							(26,362)

The purpose of the interest rate agreements issued on April 13, 2004 in the notional amount of \$448 million was to hedge the Commonwealth's variable rate debt exposure and the interest rate risks associated therewith in relation to the Puerto Rico Public Improvement Refunding Bonds, Series 2004 B.

On June 21, 2006 (with effective date of July 1, 2006), the Commonwealth entered into a basis swap agreement in the notional amount of \$1.3 billion with an amortization schedule matching the long-term maturities of outstanding general obligation and refunding bonds issued in various years from 1998 to 2005. Additional basis swap agreements are expected to cover the 2006 General Obligation Bonds awaiting issuance. Under the terms of a master swap agreement, the Commonwealth will pay quarterly commencing on October 1, 2006 a floating rate equal to the tax-exempt Bond Market Association index (BMA) in exchange for receiving a floating rate equal to 67% of the taxable London Inter-Bank Offering Rate (LIBOR) index reset each week and a fixed rate payment of 0.4409% per annum, quarterly for the term of swaps. This basis swap provides the Commonwealth the cash flow benefit of the Basis Annuity in exchange for the Commonwealth taking tax and other basis risks similar to the risks taken in its outstanding LIBOR hedged synthetic fixed rate Public Refunding Bonds, Series 2004 described above.

By using derivative financial instruments to hedge the exposure to changes in interest rates, the Commonwealth exposes itself to credit risk, market-access risk and basis risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Commonwealth, which creates a credit risk for the Commonwealth. When the fair value of the derivative contract is negative, the Commonwealth owes to the

## COMMONWEALTH OF PUERTO RICO

### Notes to Basic Financial Statements

June 30, 2006

counterparty and, therefore, does not possess credit risk. The Commonwealth minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties whose credit rating is acceptable under the investment policies of the Commonwealth.

Market risk is the adverse effect on the value of a financial statement instrument that results from a change in interest rates. The market risk associated with an interest rate swap contract is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. The Commonwealth assesses interest rate cash flows risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected cash flows and evaluating hedging opportunities. The Commonwealth maintains risk management control systems to monitor interest rate cash flow risk attributable to both the Commonwealth outstanding or forecasted debt obligations as well as the Commonwealth offsetting hedge positions.

Basis risk arises when different indexes are used in connection with a derivative. The 2006 swap exposes the government to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. If a change occurs that results in the rates moving to convergence, the expected cost savings may not be realized. The Commonwealth assesses basis risk by following the aforementioned market risks control system.

#### **(23) Special Items**

On December 12, 2001, PFC, a blended component unit of GDB, issued \$96.8 million of QZAB to finance expenditures of the Department of Education of the Commonwealth under the QZAB program described in note 14(e). Simultaneous with this QZAB issuance, The Children's Trust, a blended component unit of the Commonwealth, granted \$47.2 million to the Department of Education of the Commonwealth, which in turn deposited the money to the credit of an escrow trust account invested in guaranteed investment contracts that will be used solely for the repayment in 2015 of these QZAB. At the moment, these November 2001 QZAB were considered defeased and since then, the difference between the bond amount and the amount deposited in the escrow account has been deferred and amortized into income over the term of the bonds.

During January 2006, the Commonwealth, with Legislative approval, decided to revert the funds at the escrow account back to The Children's Trust for program expenditures and at the same time recognized in the accompanying statement of net assets of the governmental activities the QZAB obligation of \$96.8 million. Upon recognition of the QZAB, the Commonwealth derecognized the unamortized deferred difference referred to above, which amounted to approximately \$56.6 million. On the other hand, The Children's Trust recognized as revenue the funds at the escrow account which reverted back in the amount of approximately \$54.1 million. The net result of approximately \$2.5 million loss represents certain cancellation and penalties fees for unwinding the 2001 defeasance and other reconciling differences. The net effect of this transaction has been classified within special items in the accompanying statement of activities.

**COMBINING, INDIVIDUAL FUND  
FINANCIAL STATEMENTS AND SCHEDULES**

### **GENERAL FUND**

The general fund is the primary operating fund of the Commonwealth. The general fund is used to account for resources traditionally associated with government, which are not required legally or by sound financial management to be accounted for in another fund. Included are transactions for services such as general government, public safety, health, public housing and welfare, education, and economic development. Following is the supplemental schedule of expenditures – budget and actual – general fund.

COMMONWEALTH OF PUERTO RICO

Supplemental Schedule of Expenditures by Agency – Budget and Actual –  
Statutory Basis – General Fund

Year ended June 30, 2006  
(In thousands)

	Original budget	Final budget	Actual	Variance
Expenditures:				
Current:				
General government:				
Senate of Puerto Rico	\$ 35,718	35,718	35,718	—
House of Representatives of Puerto Rico	44,206	44,206	43,658	548
Comptroller's Office	40,293	40,293	40,398	(105)
Governor's Office	4,942	4,934	4,952	(18)
Office of Management and Budget	25,590	25,178	69,817	(44,639)
Planning Board	16,192	16,177	16,026	151
Constructions and Land Subdivisions Appeals Board	1,326	1,326	1,326	—
Department of State	8,007	8,106	8,095	11
Department of the Treasury	161,004	160,696	163,675	(2,979)
Central Office of Personnel Administration	7,113	7,113	7,119	(6)
Commonwealth Elections Commission	35,884	35,884	41,742	(5,858)
Federal Affairs Administration	7,296	7,296	8,012	(716)
General Services Administration	713	790	784	6
Municipal Complaints Hearing Commission	4,612	9,610	4,845	4,765
Civil Rights Commission	686	686	686	—
Office of the Citizen's Ombudsman	3,652	3,652	3,652	—
Commission of Appeals of the Human Resources System	1,482	1,482	1,484	(2)
Rules and Permits Administration	5,792	5,768	5,768	—
Commonwealth's Commission to Settle Municipal Complaints	185	170	170	—
Legislative Affairs Office	375	375	295	80
Commission for the Public Service Work Relations	1,938	1,935	1,933	2
Government Ethics Board	9,890	9,890	9,890	—
Legislative Affairs Office	8,161	8,161	8,131	30
Office of the Superintendent of the Capitol	7,204	7,204	7,174	30
Comptroller's Special Reports Joint Commission	518	518	518	—
Legislative Donation Commission	534	534	483	51
Coordination Office for Special Communities of Puerto Rico	7,252	7,492	7,470	22
Public Affairs	4,258	3,988	3,960	28
Governor's Secretary Office	9,540	9,425	9,269	156
Total general government	454,363	458,607	507,050	(48,443)
Public safety:				
Puerto Rico General Court of Justice	294,587	294,587	313,948	(19,361)
State Civil Defense Agency	—	—	3,895	(3,895)
Commission of Investigation, Processing, and Appeals Board	574	574	574	—
Department of Justice	154,720	153,930	147,694	6,236
Puerto Rico Police Department	806,157	827,365	839,524	(12,159)
Puerto Rico Firefighters Corps	72,436	69,432	70,634	(1,202)
Puerto Rico National Guard	8,336	8,668	8,667	1
Public Service Commission	11,229	11,633	11,633	—
Consumer Affairs Department	14,519	14,549	13,733	816
Juvenile Institutions Administration	77,125	87,451	88,254	(803)
Corrections Administration	319,225	386,165	413,039	(26,874)
Department of Correction and Rehabilitation	3,891	5,288	6,828	(1,540)
Natural Resources Administration	30,272	39,059	41,196	(2,137)
Parole Board	2,473	2,412	2,430	(18)
Forensic Sciences Institute	13,422	13,422	13,422	—
Special Prosecutor Panel	1,425	1,425	(32)	1,457
Pre-Trial Services Office	5,090	5,025	5,025	—
Correctional Health	81,678	81,669	95,463	(13,794)
Medical Emergencies Service	23,094	26,389	26,557	(168)
Criminal Justice University College	7,485	7,485	7,485	—
Total public safety	\$ 1,927,738	2,036,528	2,109,969	(73,441)

COMMONWEALTH OF PUERTO RICO

Supplemental Schedule of Expenditures by Agency – Budget and Actual –  
Statutory Basis – General Fund

Year ended June 30, 2006  
(In thousands)

	Original budget	Final budget	Actual	Variance
Health:				
Environmental Quality Board	\$ 8,100	9,225	9,225	—
Department of Health	283,213	311,039	336,788	(25,749)
Mental Health and Drug Addiction Services Administration	112,191	119,671	135,074	(15,403)
Drug Control	—	—	(2)	2
Cardiovascular Center Corporation of Puerto Rico and the Caribbean	3,200	21,210	21,210	—
Solid Waste Authority of Puerto Rico	5,119	5,119	5,119	—
Puerto Rico Health Insurance Administration	987,852	1,134,152	1,154,895	(20,743)
Total health	1,399,675	1,600,416	1,662,309	(61,893)
Public housing and welfare:				
Youth Affairs Office	4,375	4,323	4,705	(382)
Rural Housing Administration	7,153	7,153	7,153	—
Puerto Rico Volunteers Service Corps	9,055	9,055	9,287	(232)
Department of Labor and Human Resources	5,517	5,515	5,554	(39)
Labor Relations Board	1,006	1,005	1,005	—
Department of Housing	12,075	12,097	12,097	—
Department of Recreation and Sports	57,331	57,140	68,189	(11,049)
Administration for the Horse Racing Sport and Industry	2,320	2,620	2,620	—
Women's Affairs Commission	5,331	5,309	5,092	217
Office of the Veteran's Ombudsman	2,260	2,205	3,242	(1,037)
Department of Family	52,967	52,966	55,869	(2,903)
Family and Children Administration	145,000	144,973	145,348	(375)
Child Support Administration	10,961	10,887	10,887	—
Vocational Rehabilitation Administration	13,493	13,486	13,486	—
Social Economic Development Administration	97,776	97,110	103,029	(5,919)
Office of the Disabled Persons Ombudsman	3,212	3,210	3,210	—
Office for Elderly Affairs	3,752	3,655	3,510	145
Communities Rehabilitation Administration	—	—	(3)	3
Patient Ombudsman	4,441	4,424	4,424	—
Office of the General Auditor-Department of Family	—	—	—	—
Institutional Trust of the National Guard of Puerto Rico	332	—	—	—
Right to Employment Administration	13,958	14,958	14,958	—
Cantera's Peninsula Integral Development Company	163	163	163	—
Puerto Rico Housing Bank and Finance Authority	616	616	616	—
Industries for the Blind, Mentally Retarded, and Other Disabled Persons of Puerto Rico	150	150	150	—
Puerto Rico Infrastructure Financing Authority	—	—	—	—
Administration for the Care and Development of the Childhood	5,158	5,032	7,009	(1,977)
Total public housing and welfare	458,402	458,052	481,600	(23,548)
Education:				
Department of Education	2,207,236	2,540,926	2,678,154	(137,228)
State Office for Historic Preservation	2,159	1,927	1,920	7
General Education Council	1,734	1,720	1,720	—
Athenaeum of Puerto Rico	500	500	500	—
Institute of Puerto Rico Culture	29,068	29,068	29,068	—
Plastic Arts School	2,996	2,973	2,973	—
University of Puerto Rico	802,539	802,539	802,339	200
Musical Arts Corporation	6,295	6,295	6,295	—
Fine Arts Center Corporation	3,642	3,642	3,642	—
Puerto Rico Public Broadcasting Corporation	19,329	19,329	19,329	—
Puerto Rico Conservatory of Music Corporation	4,556	4,556	4,556	—
Puerto Rico Higher Education Council	29,553	29,553	29,553	—
Total education	\$ 3,109,607	3,443,028	3,580,049	(137,021)

COMMONWEALTH OF PUERTO RICO

Supplemental Schedule of Expenditures by Agency – Budget and Actual –  
Statutory Basis – General Fund

Year ended June 30, 2006  
(In thousands)

	Original budget	Final budget	Actual	Variance
Economic development:				
Vieques Commissioner's Office	\$ —	108	108	—
Department of Transportation and Public Works	78,250	78,247	75,301	2,946
Department of Natural and Environmental Resources	4,109	9,109	11,339	(2,230)
Department of Agriculture	24,025	22,875	36,280	(13,405)
Department of Economic Development and Commerce	—	—	—	—
Cooperative Enterprises Development Administration	3,198	3,250	3,297	(47)
Puerto Rico Highway and Transportation Authority	1,000	1,000	1,000	—
Cooperative Enterprises Inspector's Office	802	802	802	—
Rural Development Corporation	6,615	6,608	5,910	698
Department of Economic Development and Commerce	4,297	4,036	2,868	1,168
Energy Affairs Administration	150	150	150	—
Culebra Conservation and Development Authority	700	700	700	—
Puerto Rico Infrastructure Financing Authority	70,634	70,634	70,634	—
Puerto Rico Aqueduct and Sewer Authority	70,916	70,916	70,917	(1)
Puerto Rico Industrial Development Company	33,107	33,107	33,107	—
Puerto Rico Electric Power Authority	6,327	6,327	6,327	—
Government Development Bank for Puerto Rico	3,000	3,000	3,000	—
Puerto Rico Metropolitan Bus Authority	4,000	4,000	4,000	—
Puerto Rico Maritime Transportation Authority	15,500	15,569	15,569	—
Tourism Company of Puerto Rico	33,594	33,594	33,572	22
Agricultural Services and Development Administration	75,450	76,598	76,598	—
National Parks Company of Puerto Rico	13,314	15,114	15,114	—
Puerto Rico Land Authority	2,999	2,999	2,999	—
Corporation for the Development of the Film Industry in Puerto Rico	1,164	1,134	1,134	—
Puerto Rico Land Administration	—	—	—	—
Port of the Americas Authority	3,500	3,500	3,500	—
Puerto Rico Trade and Export Corporation	11,734	11,734	11,734	—
Corporation for the Development of Caño Martin Peña	—	—	—	—
Authority for Redevelopment of Roosevelt Roads	—	—	—	—
Sugar Corporation	6,819	6,819	6,819	—
Total economic development	475,204	481,930	492,779	(10,849)
Intergovernmental:				
CRIM	—	—	—	—
Municipal Service Administration	384,321	384,376	416,949	(32,573)
Total intergovernmental	384,321	384,376	416,949	(32,573)
Debt service:				
Principal	78,365	78,365	78,365	—
Interest and other	131,689	131,689	131,689	—
Total expenditures	\$ 8,419,364	9,072,991	9,460,759	(387,768)
Transfers-out to other funds:				
Office of Management and Budget	\$ 165,763	165,763	165,763	—
Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities	178,298	221,198	221,198	—
Teachers' Pensions Board	960	960	960	—
Contributions to Political Parties	603	603	603	—
Office for the Improvements of Public Schools	2,300	2,300	2,183	117
Puerto Rico Maritime Shipping Authority	29,668	29,668	29,667	1
Public Buildings Authority	15,000	15,000	15,000	—
Public Housing Administration	—	—	—	—
Budgetary Fund	—	—	—	—
Emergency Fund	—	—	—	—
Voluntary Elections Fund	—	—	—	—
Transfer of Unused Appropriation Fund (Legislative Branch only)	16,231	16,231	16,231	—
Department of Treasury – Transfer to debt service	116,812	485,012	485,012	—
Total operating transfers-out to other funds	\$ 525,635	936,735	936,617	118

See accompanying independent auditors' report.



## NONMAJOR GOVERNMENTAL FUNDS

### *Special Revenue Funds*

Special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditure for specific purposes.

**Public Buildings Authority Special Revenue Fund:** The operating fund of a blended component unit used to account for the operation, maintenance, equipment replacement, and other extraordinary operation and maintenance costs of the buildings and facilities that, when constructed, are leased to the Commonwealth's primary government agencies.

### *Debt Service Funds*

The debt service funds are used to account for the accumulation of resources predominantly for, and the payment of, general long-term bonds principal, interest, and related costs other than bonds payable from operations of proprietary fund types, pension trust funds and discretely presented component units. Long-term debt and interest due on July 1 of the following year are accounted for as a fund liability if resources are available as of June 30 for its payment.

**The Children's Trust Debt Service Fund:** The debt service fund of The Children's Trust (a blended component unit) accounts for the accumulation of resources for payment of interest and principal on long-term obligations financed with moneys to be received by the Commonwealth from the global settlement agreement signed by certain tobacco companies.

**Public Buildings Authority Debt Service Fund:** A blended component unit engaged in the construction and/or acquisition of building facilities for lease mainly to the Commonwealth's primary government agencies. Its debt service fund is used to account for the accumulation of resources for the payment of revenue bonds and other liabilities incurred to finance the construction of the buildings and facilities.

**Puerto Rico Maritime Shipping Authority Debt Service Fund:** This is the remainder of a former shipping company owned by the Commonwealth. Its debt service fund is used to account for the accumulation of resources for the payment of the long-term liability that resulted from the sale of its marine operations. This fund is mainly subsidized from appropriations and operating transfers from the general fund.

### *Capital Project Funds*

Capital project funds are used to account for the financial resources used for the acquisition or construction of major capital facilities not being financed by proprietary fund types, pension trust funds, and discretely presented component units.

**Commonwealth Public Improvements Funds and Other Funds:** These funds present the activities of the capital improvements program of the Commonwealth, financed with the proceeds of the general obligation bonds.

**COMMONWEALTH OF PUERTO RICO**  
Combining Balance Sheet -- Nonmajor Governmental Funds  
June 30, 2006  
(In thousands)

	<u>Special revenue</u>		<u>Debt service</u>			<u>Capital projects</u>	<u>Total nonmajor governmental funds</u>
<b>Assets</b>	<b>Public Buildings Authority</b>	<b>The Children's Trust</b>	<b>Public Buildings Authority</b>	<b>Puerto Rico Maritime Shipping Authority</b>	<b>Total</b>	<b>Commonwealth of Puerto Rico</b>	
Cash and cash equivalents in commercial banks	\$ 31,359	—	143,712	2,127	145,839	260,099	437,297
Cash and cash equivalents in component unit banks	57,180	—	—	2,593	2,593	382,845	442,618
Investments	—	114,453	—	—	114,453	—	114,453
Receivables:							
Accounts	12,364	—	—	—	—	671	13,035
Loans	—	—	—	—	—	36	36
Accrued interest	—	460	—	9	469	—	469
Due from:							
Other funds	101,891	—	24,103	—	24,103	30,148	156,142
Component units	42,186	—	—	—	—	—	42,186
Other governmental	13,866	—	—	—	—	—	13,866
Restricted cash and cash equivalents	16	—	—	—	—	—	16
Real estate held for future development	14,386	—	—	—	—	1,853	16,239
<b>Total assets</b>	<b>\$ 273,248</b>	<b>114,913</b>	<b>167,815</b>	<b>4,729</b>	<b>287,457</b>	<b>675,652</b>	<b>1,236,357</b>
<b>Liabilities and Fund Balances</b>							
Liabilities:							
Accounts payable and accrued liabilities	\$ 36,629	—	—	678	678	26,481	63,788
Due to component units	13,681	—	—	—	—	—	13,681
Due to other funds	—	—	—	—	—	373,385	373,385
Notes payable	30,598	—	—	—	—	—	30,598
Bonds payable	—	—	69,925	—	69,925	10	69,935
Interest payable	—	—	71,640	1,482	73,122	—	73,122
<b>Total liabilities</b>	<b>80,908</b>	<b>—</b>	<b>141,565</b>	<b>2,160</b>	<b>143,725</b>	<b>399,876</b>	<b>624,509</b>
Fund balances:							
Reserved for encumbrances	—	—	—	—	—	24,587	24,587
Unreserved reported in:							
Debt service funds	—	114,913	26,250	2,569	143,732	—	143,732
Special revenue funds	192,340	—	—	—	—	—	192,340
Capital projects funds	—	—	—	—	—	251,189	251,189
<b>Total fund balances</b>	<b>192,340</b>	<b>114,913</b>	<b>26,250</b>	<b>2,569</b>	<b>143,732</b>	<b>275,776</b>	<b>611,848</b>
<b>Total liabilities and fund balances</b>	<b>\$ 273,248</b>	<b>114,913</b>	<b>167,815</b>	<b>4,729</b>	<b>287,457</b>	<b>675,652</b>	<b>1,236,357</b>

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Revenue, Expenditures, and Changes in  
Fund Balances – Nonmajor Governmental Funds

Year ended June 30, 2006

(In thousands)

	<u>Special revenue</u>		<u>Debt service</u>			<u>Capital projects</u>	
	<u>Public Buildings Authority</u>	<u>The Children's Trust</u>	<u>Public Buildings Authority</u>	<u>Puerto Rico Maritime Shipping Authority</u>	<u>Total</u>	<u>Commonwealth of Puerto Rico</u>	<u>Total nonmajor governmental funds</u>
Revenue:							
Revenue from global tobacco settlement agreement	\$ —	65,602	—	—	65,602	—	65,602
Interest and investment earnings	7,473	4,648	—	394	5,042	—	12,515
Intergovernmental	—	—	—	—	—	22,310	22,310
Other	7,556	—	—	271	271	8,948	16,775
Total revenue	15,029	70,250	—	665	70,915	31,258	117,202
Expenditures:							
Current:							
General government	144,249	—	—	—	—	10,518	154,767
Public safety	—	—	—	—	—	797	797
Health	—	—	—	—	—	5,988	5,988
Public housing and welfare	—	—	—	—	—	11,362	11,362
Economic development	—	—	—	788	788	47,822	48,610
Intergovernmental	—	—	—	—	—	1,688	1,688
Capital outlays	—	—	—	—	—	64,820	64,820
Debt service:							
Principal	—	8,810	69,925	—	78,735	—	78,735
Interest and other	—	60,880	103,237	16,956	181,073	—	181,073
Total expenditures	144,249	69,690	173,162	17,744	260,596	142,995	547,840
Excess (deficiency) of revenue over expenditures	(129,220)	560	(173,162)	(17,079)	(189,681)	(111,737)	(430,638)
Other financing sources (uses):							
Transfers in	108,417	—	168,067	16,956	185,023	—	293,440
Transfers out	—	(391)	—	—	(391)	(6,868)	(7,259)
Long-term debt issued	105,000	—	—	—	—	16,421	121,421
Total other financing sources (uses)	213,417	(391)	168,067	16,956	184,632	9,553	407,602
Net change in fund balances	84,197	169	(5,095)	(123)	(5,049)	(102,184)	(23,036)
Fund balances, beginning of year	108,143	114,744	31,345	2,692	148,781	377,960	634,884
Fund balances, end of year	\$ 192,340	114,913	26,250	2,569	143,732	275,776	611,848

See accompanying independent auditors' report.

### **NONMAJOR PROPRIETARY FUNDS**

Proprietary funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the government is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

**Disability Insurance:** It was created by Act 139 on June 26, 1968. It is used to account for disability benefits to remedy temporarily the loss of income as a result of disability caused by sickness or accident unrelated to the employment.

**Drivers' Insurance:** It was created by Act 428 on May 15, 1950. It is used to account for contributions made by the drivers and their employers to provide a social security plan for the benefit of the drivers in Puerto Rico. The plan also includes payment of benefits for health and life insurance.

**Puerto Rico Water Pollution Control Revolving Fund:** It was created by Act No. 44 on June 21, 1988, as amended. It is administered, pursuant to Act No. 9 of June 18, 1970, as amended, by the Puerto Rico Environmental Quality Board (EQB). Pursuant to such Act, EQB is authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (EPA) for lending activities.

**Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund:** It was created by Act No. 32 on July 7, 1997. It is administered, pursuant to Act No. 9 of June 18, 1970, as amended, by the Puerto Rico Department of Health (DOH). Pursuant to such act, DOH, on behalf of the Commonwealth, is authorized to enter into operating and capitalization grant agreements with the EPA for lending activities.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Net Assets –  
Nonmajor Proprietary Funds

June 30, 2006

(In thousands)

Assets	Business-type activities – nonmajor enterprise funds				Total
	Disability insurance	Drivers' insurance	Puerto Rico Water Pollution Control Revolving Fund	Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	
Current assets:					
Cash and cash equivalents in commercial banks	\$ —	37,757	—	—	37,757
Cash and cash equivalents in government bank	82,827	—	50,454	6,342	139,623
Receivables, net:					
Insurance premiums, net	7,039	995	—	—	8,034
Component units	—	—	7,131	474	7,605
Accrued interests	190	77	1,563	457	2,287
Other	314	33	107	88	542
Restricted investments	33,473	—	—	—	33,473
Total current assets	123,843	38,862	59,255	7,361	229,321
Noncurrent assets:					
Loans receivable, excluding current portion, net:					
Component units	—	—	132,141	48,309	180,450
Intergovernmental	—	—	1,819	—	1,819
Total assets	123,843	38,862	193,215	55,670	411,590
<b>Liabilities and Net Assets</b>					
Current liabilities:					
Accounts payable and accrued liabilities	1,747	93	832	312	2,984
Deferred revenue	—	26	—	—	26
Compensated absences	1,042	477	—	—	1,519
Insurance benefits payable	783	357	—	—	1,140
Total current liabilities	3,572	953	832	312	5,669
Noncurrent liabilities – compensated absences	809	789	—	—	1,598
Total liabilities	4,381	1,742	832	312	7,267
Net assets:					
Restricted for:					
Payment of insurance benefits	119,462	37,120	—	—	156,582
Capital projects	—	—	192,383	55,358	247,741
Total net assets	\$ 119,462	37,120	192,383	55,358	404,323

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Revenue, Expenses, and Changes in Net Assets –  
Nonmajor Proprietary Funds

Year ended June 30, 2006

(In thousands)

	<b>Business-type activities – nonmajor enterprise funds</b>				
	<b>Disability insurance</b>	<b>Drivers’ insurance</b>	<b>Puerto Rico Water Pollution Control Revolving Fund</b>	<b>Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund</b>	<b>Total</b>
Operating revenue:					
Insurance premiums	\$ 19,162	4,937	—	—	24,099
Interest	—	—	4,617	1,109	5,726
Total operating revenue	19,162	4,937	4,617	1,109	29,825
Operating expenses:					
Disability and drivers insurance benefits	3,601	676	—	—	4,277
General, administrative, and other operating expenses	15,136	4,418	463	749	20,766
Total operating expenses	18,737	5,094	463	749	25,043
Operating income (loss)	425	(157)	4,154	360	4,782
Nonoperating revenue:					
Interest and investment earnings	144	749	—	—	893
Contributions from federal government	—	—	12,000	12,195	24,195
Income before transfers	569	592	16,154	12,555	29,870
Transfers from general fund	—	—	2,387	2,415	4,802
Net change in net assets	569	592	18,541	14,970	34,672
Net assets, beginning of year	118,893	36,528	173,842	40,388	369,651
Net assets, end of year	\$ 119,462	37,120	192,383	55,358	404,323

See accompanying independent auditors’ report.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Cash Flows –  
Nonmajor Proprietary Funds

Year ended June 30, 2006

(In thousands)

	Business-type activities – nonmajor enterprise funds				
	Disability insurance	Drivers' insurance	Puerto Rico Water Pollution Control Revolving Fund	Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund	Total
Cash flows from operating activities:					
Receipts from customers and users	\$ 15,986	5,039	—	—	21,025
Payments to suppliers and employees	(15,991)	(4,610)	—	—	(20,601)
Other receipts	—	—	13,971	1,277	15,248
Other payments	—	—	(21,676)	(22,083)	(43,759)
Payments of insurance benefits	(3,714)	(618)	—	—	(4,332)
Net cash used in operating activities	(3,719)	(189)	(7,705)	(20,806)	(32,419)
Cash flows from noncapital financing activities:					
Intergovernmental grants and contributions	—	—	12,000	12,107	24,107
Transfers from general fund	—	—	2,386	2,416	4,802
Net cash provided by noncapital financing activities	—	—	14,386	14,523	28,909
Cash flows from investing activities:					
Interests received on deposits and investments	676	715	—	—	1,391
Net cash provided by investing activities	676	715	—	—	1,391
Net increase (decrease) in cash and cash equivalents	(3,043)	526	6,681	(6,283)	(2,119)
Cash and equivalents, beginning of year	85,870	37,231	43,773	12,625	179,499
Cash and cash equivalents, end of year	\$ 82,827	37,757	50,454	6,342	177,380
Reconciliation of operating income (loss) to net cash used in operating activities:					
Operating income (loss)	\$ 425	(157)	4,154	360	4,782
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:					
Decrease (increase) in accounts and loans receivable	(3,176)	102	(11,679)	(20,811)	(35,564)
Interest earned on deposits, loans, and investments	—	—	(213)	(158)	(371)
Changes in operating assets and liabilities:					
Decrease in deferred revenue	—	(3)	—	—	(3)
Increase in compensated absences	1,056	395	—	—	1,451
Increase (decrease) in liability for insurance benefits payable	(465)	58	—	—	(407)
Increase (decrease) in accounts payable and accrued liabilities	(1,559)	(584)	33	(197)	(2,307)
Total adjustments	(4,144)	(32)	(11,859)	(21,166)	(37,201)
Net cash used in operating activities	\$ (3,719)	(189)	(7,705)	(20,806)	(32,419)

See accompanying independent auditors' report.



## **FIDUCIARY FUNDS**

Fiduciary funds are used to account for assets held by the Commonwealth in a trustee capacity, or as an agent for individuals, organizations, and other governmental units. Following are the Commonwealth's fiduciary funds:

### ***Pension Trust Funds***

The pension trust funds are used to account for the assets, liabilities, and net assets available for pension benefits held in trust for the public employees of the Commonwealth.

**Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS):** ERS is the administrator of a defined-benefit pension plan which covers all regular employees of the Commonwealth and its instrumentalities and of certain municipalities and component units not covered by their retirement systems. On September 24, 1999, an amendment to the Law that created ERS was enacted with the purpose of establishing a new defined-contribution pension plan (System 2000) for persons joining the government on or after January 1, 2000.

**Puerto Rico System of Annuities and Pensions for Teachers (TRS):** TRS provides retirement benefits to all teachers of the Department of Education of the Commonwealth, all pensioned teachers who work in the Teachers' Association of Puerto Rico, and those who practice in private institutions accredited by the Department of Education. TRS provides retirement, death, and disability benefits.

**Puerto Rico Judiciary Retirement System (JRS):** JRS is administered by the ERS and covers all individuals holding a position as Justice of the Supreme Court, Judge of the former Superior Court, Judge of District Court, or the Municipal Judges of the Commonwealth. The system provides retirement as well as death and disability benefits.

### ***Agency Fund***

Agency fund is used to account for assets held by the Commonwealth as an agent for individuals, private organizations, and other governments. This fund is custodial in nature (assets equal liabilities) and does not involve measurement of the results of operations.

**Special Deposits:** This fund acts in a fiduciary capacity in order to account for moneys received with specified purposes for which the law does not specify its recording in any other fund. It mainly includes deposits under the custody of the courts of justice for alimony payments.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Fiduciary Net Assets – Pension Trust Funds

June 30, 2006

(In thousands)

Assets	Pension Trust Funds			Totals
	Employees' Retirement System (ERS)	Teachers' Retirement System (TRS)	Judiciary Retirement System (JRS)	
Cash and cash equivalents in commercial banks:				
Unrestricted	\$ 27,849	53,515	1,599	82,963
Restricted	—	1,717	—	1,717
Cash and cash equivalents in governmental banks:				
Unrestricted	25,778	2,993	180	28,951
Restricted	2,156	—	—	2,156
Investments:				
Debt and equity securities, at fair value	1,531,726	2,350,099	75,930	3,957,755
Investment in PRTA Holdings, at appraised value	495,318	—	—	495,318
Other	41,609	46,215	—	87,824
Receivables, net:				
Accounts	44,622	—	—	44,622
Loans and advances	528,552	352,333	274	881,159
Accrued interests and dividends	26,105	6,371	250	32,726
Due from (to) other pension trust funds	3,161	—	(3,161)	—
Due from general fund	10,401	—	—	10,401
Other	23,579	27,095	606	51,280
Capital assets, net	7,694	25,665	—	33,359
Other assets	7,592	691	—	8,283
Total assets	<u>2,776,142</u>	<u>2,866,694</u>	<u>75,678</u>	<u>5,718,514</u>
<b>Liabilities</b>				
Accounts payable and accrued liabilities	35,737	39,373	2,828	77,938
Repurchase agreements	139,074	—	—	139,074
Bonds payable	—	20,430	—	20,430
Other	60,000	—	—	60,000
Due to component unit	—	4	—	4
Total liabilities	<u>234,811</u>	<u>59,807</u>	<u>2,828</u>	<u>297,446</u>
<b>Net Assets</b>				
Net assets held in trust for pension and other benefits	<u>\$ 2,541,331</u>	<u>2,806,887</u>	<u>72,850</u>	<u>5,421,068</u>

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**

Combining Statement of Changes in Fiduciary Net Assets – Pension Trust Funds

Year ended June 30, 2006

(In thousands)

	Pension Trust Funds			Totals
	Employees' Retirement System (ERS)	Teachers' Retirement System (TRS)	Judiciary Retirement System (JRS)	
Additions:				
Contributions:				
Sponsor	\$ 398,372	119,199	6,727	524,298
Participants	342,697	129,473	2,960	475,130
Special	16,684	61,066	—	77,750
Total contributions	<u>757,753</u>	<u>309,738</u>	<u>9,687</u>	<u>1,077,178</u>
Interest	63,486	57,899	1,220	122,605
Dividends	49,938	14,684	205	64,827
Net change in fair value of investments, including realized gains on sale and maturities of investments	189,515	258,182	5,818	453,515
Investment expenses	(10,123)	(5,792)	(279)	(16,194)
Net interest and investment income	<u>292,816</u>	<u>324,973</u>	<u>6,964</u>	<u>624,753</u>
Other income	23,270	13,085	—	36,355
Total additions	<u>1,073,839</u>	<u>647,796</u>	<u>16,651</u>	<u>1,738,286</u>
Deductions:				
Pension and other benefits	804,315	375,262	12,403	1,191,980
Refunds of contributions	22,373	4,135	—	26,508
General and administrative expenses	33,691	22,651	1,195	57,537
Total deductions	<u>860,379</u>	<u>402,048</u>	<u>13,598</u>	<u>1,276,025</u>
Net change in net assets held in trust for pension and other benefits	213,460	245,748	3,053	462,261
Net assets held in trust for pension and other benefits:				
Beginning of year	<u>2,327,871</u>	<u>2,561,139</u>	<u>69,797</u>	<u>4,958,807</u>
End of year	<u>\$ 2,541,331</u>	<u>2,806,887</u>	<u>72,850</u>	<u>5,421,068</u>

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**  
Statement of Changes in Assets and Liabilities – Agency Fund  
Year ended June 30, 2006  
(In thousands)

<b>Assets</b>	<b>Balance June 30, 2005</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance June 30, 2006</b>
Cash and cash equivalents in commercial banks and U.S. Treasury	\$ 467,319	115,877	—	583,196
Cash and cash equivalents in governmental banks	110,102	2,864,683	2,927,801	46,984
Investments	16,115	10,898	—	27,013
Total assets	<u>\$ 593,536</u>	<u>2,991,458</u>	<u>2,927,801</u>	<u>657,193</u>
<b>Liabilities</b>				
Accounts payable and accrued liabilities	\$ 593,536	1,521,669	1,458,012	657,193
Total liabilities	<u>\$ 593,536</u>	<u>1,521,669</u>	<u>1,458,012</u>	<u>657,193</u>

See accompanying independent auditors' report.

#### **NONMAJOR COMPONENT UNITS**

These entities are presented because the nature and significance of their relationship with the primary government are such that their exclusion would cause the basic financial statements to be misleading. These are discretely presented in a separate column in the basic financial statements due to nature of the services they provide. The accounting principles followed by each of the component units included herein may vary depending on the type of industries they are involved in (that is, banking, construction, public utilities, and so forth). The detailed information for each of these entities may be obtained directly from the administrative offices of the corresponding entities, as described in note 1 to the basic financial statements included in the financial section of this report.

**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units – Statement of Net Assets  
June 30, 2006  
(In thousands)

Assets	Agricultural Services and Development Administration	Automobile Accident Compensation Administration	Cardiovascular Center Corporation of Puerto Rico and the Caribbean	Caribbean Basin Projects Financing Authority	Culebra Conservation & Development Authority	Economic Development Bank for Puerto Rico	Employment and Training Enterprises Corporation	Farm Insurance Corporation of Puerto Rico	Fine Arts Center Corporation	Governing Board of the 9-1-1 Service	Institutional Trust of the National Guard of Puerto Rico	Land Authority of Puerto Rico
Current assets:												
Cash and cash equivalents	\$ 11	392	2,428	—	376	3,290	—	6,247	1,180	—	—	2,092
Cash and cash equivalents in governmental banks	—	4,118	—	104	—	—	637	—	—	18,557	55,064	27,456
Investments, including collateral from securities lending transactions	—	219,600	—	—	—	210,041	—	—	—	—	654	—
Receivables, net:												
Insurance premiums	—	—	—	—	—	—	—	—	—	—	—	—
Intergovernmental	—	—	—	—	—	—	—	—	—	—	—	—
Accounts	75	4,825	19,752	—	—	—	1,033	693	154	3,840	—	13,089
Loans and advances	—	—	—	—	—	53,028	—	—	—	—	—	379
Accrued interest	—	1,043	—	—	—	10,561	—	—	—	51	—	—
Other governmental entities	11,263	—	—	—	—	—	—	—	251	255	—	—
Other	5,637	12,105	1,233	—	—	—	—	—	—	—	3,418	1,302
Due from:												
Primary government	—	—	—	—	—	—	—	—	—	—	—	5,301
Component units	—	—	—	—	—	—	—	—	—	—	—	16,931
Inventories	17,623	—	1,824	—	—	—	595	—	—	30	—	—
Prepays	569	—	652	—	—	—	—	331	160	—	—	—
<b>Total current assets</b>	<b>35,178</b>	<b>242,083</b>	<b>25,889</b>	<b>104</b>	<b>376</b>	<b>276,920</b>	<b>2,265</b>	<b>7,271</b>	<b>1,745</b>	<b>22,733</b>	<b>59,136</b>	<b>66,550</b>
Noncurrent assets:												
Restricted assets:												
Cash and cash equivalents	183,286	336	1,067	—	—	—	1,959	—	—	—	—	895
Cash and cash equivalents in governmental banks	—	—	—	—	—	—	30	—	—	15,408	3,000	983
Investments	—	—	—	—	—	—	—	—	620	—	—	—
Investments	—	—	—	—	—	649,922	—	—	2,428	—	—	4,865
Receivables:												
Loans, interest and other	—	—	—	—	—	109,431	—	—	—	—	—	605
Interest-bearing deposits with other	—	—	—	—	—	—	—	—	—	—	—	—
Other governmental entities	—	—	—	—	—	—	—	958	—	127	—	—
Other	—	—	—	—	—	—	—	—	—	—	—	—
Due from:												
Component units	—	—	—	—	—	—	—	13,386	—	—	—	—
Property held for sale and future development	—	—	—	—	—	—	—	—	—	—	—	—
Capital assets, not being depreciated	6,787	901	5,015	—	651	—	—	—	3,100	—	1,483	81,544
Capital assets, depreciable, net	26,444	8,982	5,647	—	375	10,597	416	225	15,527	5,766	3,938	10,110
Deferred expenses and other assets	540	28	—	—	—	4,640	—	—	—	—	2,059	78
<b>Total noncurrent assets</b>	<b>217,057</b>	<b>10,247</b>	<b>11,729</b>	<b>—</b>	<b>1,026</b>	<b>774,590</b>	<b>2,405</b>	<b>14,569</b>	<b>21,675</b>	<b>21,301</b>	<b>10,480</b>	<b>99,080</b>
<b>Total assets</b>	<b>\$ 252,235</b>	<b>252,330</b>	<b>37,618</b>	<b>104</b>	<b>1,402</b>	<b>1,051,510</b>	<b>4,670</b>	<b>21,840</b>	<b>23,420</b>	<b>44,034</b>	<b>69,616</b>	<b>165,630</b>

See accompanying independent auditors' report.

**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units – Statement of Net Assets  
June 30, 2006  
(In thousands)

Assets	Musical Arts Corporation	National Parks Company of Puerto Rico	Public Corporation for the Supervision and Deposit Insurance of Puerto Rico Cooperatives	Puerto Rico Conservatory of Music Corporation	Puerto Rico Convention Center District Authority	Puerto Rico Council on Higher Education	Puerto Rico Industrial Development Company	Puerto Rico Industrial, Tourist, Educational, Medical, and Environmental Control Facilities Financing Authority	Puerto Rico Land Administration	Puerto Rico Medical Services Administration	Puerto Rico Metropolitan Bus Authority	Puerto Rico Municipal Finance Agency
Current assets:												
Cash and cash equivalents	\$ 2,219	365	—	342	21,343	—	12,863	—	1,037	5,730	34	—
Cash and cash equivalents in governmental banks	—	1,713	1,193	—	1,030	2,186	9,100	8,223	85,662	—	9	3,598
Investments, including collateral from securities lending transactions	—	—	97,349	—	—	—	—	—	23,304	—	—	357,739
Receivables, net:												
Insurance premiums	—	—	—	—	—	—	—	—	—	—	—	—
Intergovernmental	—	—	—	—	—	—	—	—	—	—	1,925	—
Accounts	52	796	—	—	6,944	247	21,697	—	3,353	12,878	—	—
Loans and advances	—	—	—	—	—	—	469	—	—	—	—	—
Accrued interest	—	—	1,797	—	—	—	3,398	30	836	—	—	—
Other governmental entities	555	25	—	286	—	—	—	—	8	28,144	—	—
Other	21	—	210	41	40	—	20,411	—	7	—	4,120	—
Due from:												
Primary government	—	—	—	23,908	—	—	23,403	—	—	19,937	—	—
Component units	—	—	—	—	—	—	—	—	710	—	—	—
Inventories	—	—	—	—	—	—	—	—	—	4,711	6,438	—
Prepays	—	618	—	16	1,348	—	1,447	—	119	—	—	—
Total current assets	2,847	3,517	100,549	24,593	30,705	2,433	92,788	8,253	115,036	71,400	12,526	361,337
Noncurrent assets:												
Restricted assets:												
Cash and cash equivalents	—	1,005	—	856	—	—	82,694	—	—	2,372	—	82
Cash and cash equivalents in governmental banks	—	34,039	—	—	—	7,675	25,581	—	442	—	267	—
Investments	—	—	—	—	92,233	—	—	—	—	—	—	1,718,918
Investments	—	—	35,942	—	—	—	4,422	—	—	—	—	—
Receivables:												
Loans, interest and other	—	—	—	—	—	—	3,475	—	—	—	—	—
Interest-bearing deposits with other	—	—	—	—	6,659	—	—	—	—	—	—	—
Other governmental entities	—	—	—	—	—	—	—	—	778	—	—	—
Other	—	—	—	—	—	—	531	—	—	—	—	—
Due from:												
Component units	—	—	—	—	—	—	—	—	3,917	—	—	—
Property held for sale and future development	—	—	—	—	150	—	5,832	—	135,217	—	—	—
Capital assets, not being depreciated	153	27,573	—	19,871	196,966	—	280,077	—	23,341	7,322	2,569	—
Capital assets, depreciable, net	439	211,737	160	1,922	454,525	407	440,741	—	5,669	36,180	65,032	—
Deferred expenses and other assets	—	—	—	—	17,098	—	3,525	—	18	—	—	1,853
Total noncurrent assets	592	274,354	36,102	22,649	767,631	8,082	846,878	—	169,382	45,874	67,868	1,720,853
Total assets	\$ 3,439	277,871	136,651	47,242	798,336	10,515	939,666	8,253	284,418	117,274	80,394	2,082,190

See accompanying independent auditors' report.



**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units – Statement of Net Assets  
June 30, 2006  
(In thousands)

Assets	Puerto Rico Ports Authority	Puerto Rico Public Broadcasting Corporation	Puerto Rico School of Plastic Arts	Puerto Rico Solid Waste Authority	Puerto Rico Telephone Authority	Puerto Rico Tourism Company	Puerto Rico Trade and Export Company	Right to Employment Administration	Special Communities Perpetual Trust	State Insurance Fund Corporation	Total
<b>Current assets:</b>											
Cash and cash equivalents	1,367	4,203	—	—	—	49,875	1,771	—	—	2,690	119,855
Cash and cash equivalents in governmental banks	—	—	456	420	463	—	8,917	5,612	—	204,267	438,785
Investments, including collateral from securities lending transactions	—	—	—	—	—	102,151	—	—	—	641,694	1,652,532
Receivables, net:											
Insurance premiums	—	—	—	—	—	—	—	—	—	109,780	109,780
Intergovernmental	—	—	—	—	—	—	—	—	—	—	1,925
Accounts	79,841	499	85	1,733	—	4,585	112	—	—	—	176,283
Loans and advances	—	—	—	—	—	—	—	—	—	—	53,876
Accrued interest	—	98	—	—	—	—	7,065	1,015	89	10,462	35,332
Other governmental entities	—	296	—	—	—	—	92	16	—	—	41,992
Other	—	—	—	—	—	1,427	—	—	—	22,738	73,022
Due from:											
Primary government	—	—	—	—	—	—	—	—	—	—	72,549
Component units	563	—	—	—	—	—	—	—	—	3,500	21,141
Inventories	5,048	136	—	—	—	—	—	—	—	7,681	39,465
Prepaids	—	—	—	—	—	4	59	96	—	—	10,603
<b>Total current assets</b>	<b>86,819</b>	<b>5,232</b>	<b>541</b>	<b>2,153</b>	<b>463</b>	<b>158,042</b>	<b>18,016</b>	<b>6,739</b>	<b>89</b>	<b>1,002,812</b>	<b>2,847,140</b>
<b>Noncurrent assets:</b>											
Restricted assets:											
Cash and cash equivalents	39,506	4,180	16	3,461	—	—	5,261	—	—	—	326,976
Cash and cash equivalents in governmental banks	1,875	—	318	19,201	21,375	—	15,966	458	569,414	—	716,322
Investments	1,000	—	771	800	1,850	16,087	400,000	303	—	754,632	2,214,693
Receivables:											
Loans, interest and other	—	—	—	—	6,808	—	895	—	—	—	121,214
Interest-bearing deposits with other	30,800	—	—	—	—	—	—	—	—	—	6,659
Other governmental entities	—	—	—	—	—	—	—	—	—	—	32,663
Other	—	—	—	—	—	—	—	—	—	—	331
Due from:											
Component units	—	—	—	—	—	—	—	—	—	—	17,303
Property held for sale and future development	483,967	10,100	—	—	—	—	—	—	—	—	141,199
Capital assets, not being depreciated	316,491	12,671	8,702	41,841	—	11,635	70,953	—	—	13,010	1,288,839
Capital assets, depreciable, net	6,588	358	—	135,608	—	26,535	37,712	345	—	99,799	1,960,702
Deferred expenses and other assets	—	—	—	—	—	7,907	26	—	—	—	44,498
<b>Total noncurrent assets</b>	<b>880,007</b>	<b>27,309</b>	<b>9,807</b>	<b>218,911</b>	<b>30,033</b>	<b>62,164</b>	<b>530,803</b>	<b>1,106</b>	<b>569,414</b>	<b>867,441</b>	<b>8,341,419</b>
<b>Total assets</b>	<b>\$ 966,826</b>	<b>\$ 32,541</b>	<b>\$ 10,348</b>	<b>\$ 221,064</b>	<b>\$ 30,496</b>	<b>\$ 220,206</b>	<b>\$ 548,819</b>	<b>\$ 7,845</b>	<b>\$ 569,503</b>	<b>\$ 1,870,253</b>	<b>\$ 11,188,559</b>

See accompanying independent auditors' report.

(Continued)

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COMMONWEALTH OF PUERTO RICO												
Nonmajor Discretely Presented Component Units -- Statement of Net Assets												
June 30, 2006												
(In thousands)												
Liabilities and Net Assets												
Current liabilities:												
Accounts payable and accrued liabilities												
	\$	196,357	12,118	19,630	89	288,246	—	—	—	—	—	—
Due to:												
Primary government		23,886	—	—	—	331	—	—	—	—	—	—
Component units		—	—	—	—	—	—	—	—	—	—	—
Other governmental entities		—	—	—	—	—	—	—	—	—	—	—
Securities lending transactions and reverse		—	—	—	—	—	—	—	—	—	—	—
repurchase agreements		—	—	—	—	—	—	—	—	—	—	—
Interest payable		—	—	—	—	—	—	—	—	—	—	—
Deferred revenue		—	37,036	—	36	—	—	—	—	—	—	—
Notes payable, current portion		—	—	—	—	—	—	—	—	—	—	—
Commonwealth appropriation bonds, current portion		—	—	—	—	—	—	—	—	—	—	—
Bonds payable, current portion		—	—	—	—	—	—	—	—	—	—	—
Accrued compensated absences		10,761	3,990	2,102	71	—	—	—	—	—	—	—
Workers' compensation claims		—	—	—	—	—	—	—	—	—	—	—
Reserves for automobile accident benefit payments		—	—	—	—	—	—	—	—	—	—	—
Current portion of other long-term liabilities		236	114,388	365	—	4,550	—	—	—	—	—	—
Total current liabilities		231,240	215,105	69,437	196	418,079	2,808	17,274	1,724	7,864	2,184	121,563
Noncurrent liabilities:												
Due to:												
Primary government		117,758	—	—	—	11,876	7,108	—	—	—	—	—
Component units		—	—	—	—	—	—	—	—	—	—	—
Interest payable		—	—	—	—	—	—	—	—	—	—	—
Deferred revenue		—	—	—	—	—	—	—	—	—	—	—
Notes payable		10,238	—	—	—	500,000	788	—	—	—	—	—
Bonds payable		—	—	—	—	—	—	—	—	—	—	—
Accrued compensated absences		—	—	—	—	—	—	—	—	—	—	—
Other long-term liabilities		673	—	—	—	2,118	—	—	—	—	—	—
Total noncurrent liabilities		128,669	1,070	—	19	514,531	7,896	—	—	—	—	—
Total liabilities		359,909	215,105	70,507	5	932,610	10,704	17,274	2,356	7,864	2,184	290,542
Net assets:												
Invested in capital assets, net of related debt												
Restricted for:		—	9,883	10,662	—	1,026	416	225	18,100	5,505	5,420	91,604
Trust -- nonexpendable		—	—	—	—	—	—	—	—	—	—	—
Capital projects		—	—	—	—	—	—	—	—	—	—	—
Debt service		—	—	—	—	—	—	—	—	—	—	—
Affordable housing and related loan insurance		—	—	—	—	—	—	—	—	—	—	—
programs		—	—	—	—	—	—	—	—	—	—	—
Student loans and other educational purposes		—	—	—	—	—	—	—	—	—	—	—
Other specified purposes		—	—	—	—	—	—	—	—	—	—	—
Unrestricted		(107,674)	336	27,006	99	8,984	4,341	2,344	15,408	59,012	2,500	(217,268)
Total net assets		(107,674)	37,225	(32,889)	99	111,526	(6,450)	2,344	15,408	59,012	2,500	(217,268)
Total liabilities and net assets		252,235	252,235	37,618	104	1,051,510	4,670	21,840	23,420	44,034	69,616	165,630

See accompanying independent auditors' report.



(Continued)

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COMMONWEALTH OF PUERTO RICO											
Nonmajor Discretely Presented Component Units – Statement of Net Assets											
June 30, 2006											
(In thousands)											
Liabilities:											
Current liabilities:											
Accounts payable and accrued liabilities											
Due to:											
Primary government											
Component units											
Other governmental entities											
Securities lending transactions and reverse											
repurchase agreements											
Interest payable											
2,295											
441											
122,464											
Notes payable, current portion											
Commonwealth appropriation bonds, current portion											
Bonds payable, current portion											
4,545											
7,558											
Accrued compensated claims											
Worker's compensated absences											
Reserves for automobile accident benefit payments											
13,865											
Total current liabilities											
Due to:											
Primary government											
Component units											
Other governmental entities											
Securities lending transactions and reverse											
repurchase agreements											
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**COMMONWEALTH OF PUERTO RICO**  
Nonmajor Discretely Presented Component Units - Statement of Activities  
Year ended June 30, 2006  
(In thousands)

Component units	Expenses	Program revenues	Capital grants and contributions	Net revenues (expenses) and changes in net assets	Payments from primary government	Payments from (to) other component units	Contributions not restricted to specific programs	Taxes	Interest and investment earnings	Gain (loss) on sale of assets	Miscellaneous	Change in net assets	Net assets, beginning as restated	Net assets, end of year
Agricultural Services and Development Administration	\$ 166,649	\$ 9,090	\$ —	\$ (165,559)	\$ 85,029	\$ —	\$ —	\$ —	\$ 13,536	\$ —	\$ 2,410	\$ (18,120)	\$ (89,554)	\$ (107,694)
Automobile Accident Compensation Administration	105,147	20,747	—	(84,397)	—	—	—	—	—	—	—	(14,964)	51,189	37,225
Cardiovascular Center Corporation of Puerto Rico and the Caribbean	70,349	61,936	—	(8,413)	4,702	—	—	—	207	—	—	(3,594)	(29,385)	(32,889)
Caribbean Basin Projects Financing Authority	893	—	—	(7)	—	—	—	—	3	—	—	(4)	103	99
Culebra Conservation and Development Authority	37,971	38,453	—	(482)	800	—	—	—	5,326	—	—	5,808	1,058	1,187
Electric Utility Administration	8,458	3,560	—	(4,898)	—	—	—	—	98	—	—	(4,996)	11,586	11,684
Employment and Labor Relations Corporation	8,658	2,777	—	(5,881)	723	—	—	—	—	—	—	(423)	(5,611)	(6,034)
Farm Insurance Corporation of Puerto Rico	6,037	2,107	—	(3,930)	—	—	—	—	101	—	241	3,596	970	4,566
Fine Arts Center Corporation	16,767	22,285	—	(5,518)	4,530	—	—	—	139	—	—	1,459	19,605	21,064
Governing Board of the 911 Service	8,120	18,543	—	10,423	—	—	—	—	1,305	—	60	7,083	29,087	36,170
Institutional Trust of the National Guard of Puerto Rico	28,875	32,668	—	(3,793)	3,893	—	—	14,921	2,279	—	—	22,538	55,174	67,432
Land Authority of Puerto Rico	10,425	852	—	(9,573)	6,334	—	—	—	—	—	—	2,685	(149,557)	(124,912)
Maritime Services Corporation and Subsidiaries	46,086	11,972	—	(34,114)	19,960	—	—	466	1,692	—	1,159	(1,385)	253,134	243,737
National Parks Company of Puerto Rico	6,743	12,654	—	7,218	—	—	—	—	5,425	—	1,065	12,643	113,531	126,174
Public Corporation for the Supervision and Deposit Insurance of Puerto Rico	7,472	1,307	—	(6,165)	—	—	—	—	—	—	—	14,724	29,756	44,480
Puerto Rico Conservatory of Music Corporation	66,091	22,474	36	(43,617)	1,483	—	—	11,475	926	2,336	907	(26,480)	138,815	112,335
Puerto Rico Convention Center District Authority	33,543	182	—	(33,361)	29,487	—	—	—	343	—	—	1,004	10,043	9,645
Puerto Rico Council on Higher Education	97,937	63,147	36	(34,754)	19,643	—	—	—	6,112	6,434	(42,241)	(44,806)	438,794	413,988
Puerto Rico Department of Health, Medical, and Environmental Control Facilities Financing Authority	231	420	—	189	—	—	—	—	296	—	—	485	7,667	8,152
Puerto Rico Land Administration	20,153	32,698	—	12,445	—	—	—	—	3,389	—	57	16,224	225,481	241,705
Puerto Rico Medical Services Administration	159,504	104,234	—	(55,270)	27,033	—	—	—	464	(28)	—	(27,801)	(20,463)	(48,264)
Puerto Rico Metropolitan Bus Authority	82,112	32,397	21,643	(28,072)	19,956	—	—	—	44	—	—	(8,032)	27,212	19,180
Puerto Rico Municipal Finance Agency	106,082	—	—	(106,082)	—	—	—	—	49,915	—	—	(18,167)	116,361	66,194
Puerto Rico Public Broadcasting Corporation	181,780	144,830	—	(36,950)	2,500	—	3,715	—	1,692	—	26,169	1,575	21,806	33,721
Puerto Rico School of Plastic Arts	2,415	2,241	—	(174)	23,841	—	—	—	255	—	518	1,915	21,806	23,721
Puerto Rico Solid Waste Authority	5,732	1,222	—	(4,510)	2,996	—	—	—	74	—	—	(548)	10,468	9,920
Puerto Rico Telephone Authority	14,493	—	—	(14,493)	4,429	—	—	—	761	—	—	(8,081)	114,189	106,108
Puerto Rico Tourism Company	293,932	318,406	—	(24,474)	11,869	(69,035)	—	39,415	302	—	—	(3,640)	10,643	7,003
Puerto Rico Trade and Export Company	41,300	16,328	—	(24,972)	15,143	—	(5)	—	632	—	379	13,449	11,745	25,194
Rights of Puerto Rico Citizens and Residents Special Communities Perpetual Trust	28,967	—	7,126	(21,841)	19,683	—	—	—	14,380	—	94	125,033	125,033	130,508
State Insurance Fund Corporation	1,545	—	—	(1,545)	—	252	—	—	229	—	3	(1,965)	209,288	76,088
Total nonmajor	\$ 2,485,772	\$ 1,829,229	\$ 37,742	\$ (658,783)	\$ 323,553	\$ (68,783)	\$ 3,715	\$ 66,277	\$ 188,311	\$ 8,737	\$ (8,231)	\$ (80,968)	\$ 2,739,530	\$ 2,658,562

See accompanying independent auditors' report.

## **STATISTICAL SECTION**

## STATISTICAL SECTION

This part of the Commonwealth of Puerto Rico's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the Commonwealth's overall financial health.

Contents	Pages
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Financial Trends	1 – 4
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These schedules contain trend information to help the reader understand how the Commonwealth's financial performance and well-being have changed over time.

Revenue Capacity	5
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This schedule contains information to help the reader assess the Commonwealth's most significant local revenue sources.

Debt Capacity	6 – 7
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These schedules present information to help the reader assess the affordability of the Commonwealth's current levels of outstanding debt and the Commonwealth's ability to issue additional debt in the future.

Demographic and Economic Information	8 – 10
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These schedules offer demographic and economic indicators to help the reader understand the environment within which the Commonwealth's financial activities take place.

Operating Information	11
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This schedule contains service data to help the reader understand how the information in the Commonwealth's financial report relates to the services the government provides and the activities it performs.

Sources: Unless otherwise noted, the information in these schedules is derived from the comprehensive annual financial reports for the relevant year.



**COMMONWEALTH OF PUERTO RICO**

Statements of Changes in Net Assets

Last Four Fiscal Years

Accrual Basis of Accounting

(In thousands)

	2006	2005	2004	2003
Expenses:				
Governmental activities:				
General government	\$ 2,844,494	1,827,816	1,963,879	2,324,715
Public safety	2,217,294	2,580,951	1,950,635	1,606,272
Health	1,422,813	2,364,110	2,386,735	1,903,811
Public housing and welfare	3,287,559	3,443,886	2,919,315	3,239,366
Education	4,110,669	5,000,686	3,684,331	3,375,815
Economic development	564,447	1,006,945	896,925	451,945
Intergovernmental	440,390	—	591,237	466,762
Interest and other	882,163	845,556	778,700	671,228
Total governmental activities	<u>15,769,829</u>	<u>17,069,950</u>	<u>15,171,757</u>	<u>14,039,914</u>
Business-type activities:				
Lotteries	670,425	699,407	731,344	695,888
Unemployment	207,483	197,967	142,652	343,243
Other	25,043	32,437	26,763	22,385
Total business-type activities	<u>902,951</u>	<u>929,811</u>	<u>900,759</u>	<u>1,061,516</u>
Total primary government expenses	<u>16,672,780</u>	<u>17,999,761</u>	<u>16,072,516</u>	<u>15,101,430</u>
Program revenue:				
Governmental activities:				
Charges for services	828,993	702,691	769,207	757,116
Operating grants and contributions	4,365,711	4,096,204	1,038,776	3,830,639
Capital grants and contributions	100,990	121,083	2,592,055	173,644
Total governmental activities	<u>5,295,694</u>	<u>4,919,978</u>	<u>4,400,038</u>	<u>4,761,399</u>
Business activities:				
Charges for services	1,149,426	1,187,009	1,136,705	1,132,285
Operating grants and contributions	59,613	22,315	59,728	97,033
Total business-type activities	<u>1,209,039</u>	<u>1,209,324</u>	<u>1,196,433</u>	<u>1,229,318</u>
Net (expense) revenue:				
Governmental activities	(10,474,135)	(12,149,972)	(10,771,719)	(9,278,515)
Business-type activities	306,088	279,513	295,674	167,802
Total primary government net expense	<u>\$ (10,168,047)</u>	<u>(11,870,459)</u>	<u>(10,476,045)</u>	<u>(9,110,713)</u>
General revenue:				
Governmental activities:				
Taxes:				
Income	\$ 6,255,391	5,526,006	5,191,080	4,941,128
Excise	2,013,998	2,101,216	1,924,610	1,894,729
Other	15,145	7,128	19,211	3,055
Revenue from global settlement agreement	66,796	106,521	70,420	101,849
Unrestricted investment earnings	117,080	116,686	60,585	85,565
Revenue from component units	68,745	474,069	175,729	111,752
Grants and contributions not restricted to specific programs	196,721	102,691	5,706	103,423
Payment from agency fund	—	—	—	—
Special item	(2,485)	—	(35,646)	(203,514)
Gain on sale of assets	19,588	—	—	—
Transfers	242,642	492,796	203,258	279,060
Other	203,525	322,185	384,719	214,381
Total governmental activities	<u>9,197,146</u>	<u>9,249,298</u>	<u>7,999,672</u>	<u>7,531,428</u>
Business-type activities:				
Unrestricted investments earnings	33,165	32,284	23,831	77,362
Revenue from component units	—	—	—	1,038
Grants and contributions not restricted to specific programs	—	—	—	—
Transfers	(242,642)	(492,796)	(203,258)	(279,060)
Total business-type activities	<u>(209,477)</u>	<u>(460,512)</u>	<u>(179,427)</u>	<u>(200,660)</u>
Total primary government	<u>8,987,669</u>	<u>8,788,786</u>	<u>7,820,245</u>	<u>7,330,768</u>
Change in net assets:				
Governmental activities	(1,276,989)	(2,900,674)	(2,772,047)	(1,747,087)
Business-type activities	96,611	(180,999)	116,247	(32,858)
Total primary government	<u>\$ (1,180,378)</u>	<u>(3,081,673)</u>	<u>(2,655,800)</u>	<u>(1,779,945)</u>

**COMMONWEALTH OF PUERTO RICO**

Statements of Net Assets by Component

Last Four Fiscal Years

Accrual Basis of Accounting

(In thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Governmental activities:</b>				
Invested in capital assets, net of related debt	\$ 3,485,882	3,774,098	3,133,230	1,969,864
Restricted	280,078	296,692	—	19,749
Unrestricted (deficit)	<u>(20,975,523)</u>	<u>(19,987,579)</u>	<u>(16,789,576)</u>	<u>(13,942,397)</u>
Total governmental activities net assets	<u>(17,209,563)</u>	<u>(15,916,789)</u>	<u>(13,656,346)</u>	<u>(11,952,784)</u>
<b>Business-type activities:</b>				
Invested in capital assets, net of related debt	1,008	847	1,672	1,895
Restricted	947,507	872,215	853,194	736,947
Unrestricted (deficit)	<u>(171,015)</u>	<u>(202,212)</u>	<u>(3,037)</u>	<u>(3,260)</u>
Total business-type activities net assets	<u>777,500</u>	<u>670,850</u>	<u>851,829</u>	<u>735,582</u>
<b>Primary government:</b>				
Invested in capital assets, net of related debt	3,486,890	3,774,945	3,134,902	1,971,759
Restricted	1,227,585	1,168,907	853,194	756,696
Unrestricted (deficit)	<u>(21,146,538)</u>	<u>(20,189,791)</u>	<u>(16,792,613)</u>	<u>(13,945,657)</u>
Total primary government net assets	<u>\$ (16,432,063)</u>	<u>(15,245,939)</u>	<u>(12,804,517)</u>	<u>(11,217,202)</u>

COMMONWEALTH OF PUERTO RICO

Statements of Changes in Fund Balances of Governmental Funds

All Governmental Fund Types

Last Ten Fiscal Years

(In thousands)

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
<b>Revenue:</b>										
<b>Taxes:</b>										
Income	\$ 6,181,995	5,564,673	5,061,761	4,874,795	4,843,852	4,536,840	4,967,138	4,413,860	3,989,239	3,622,988
Excise	2,013,998	2,101,216	1,924,610	1,894,729	1,713,098	1,788,992	1,736,539	1,714,444	1,884,348	1,827,305
Other	15,145	7,128	19,211	3,055	1,963	92,024	87,523	78,926	73,426	64,910
Charges for services	828,993	702,691	750,978	780,905	535,423	645,806	617,020	457,454	569,096	464,034
Intergovernmental	4,663,422	4,319,977	3,654,766	4,107,706	3,634,358	3,807,049	2,971,528	3,417,647	3,009,169	3,077,042
Interest	117,080	116,686	58,914	85,565	90,940	67,020	91,525	97,880	116,030	110,777
Other	334,591	869,338	629,426	436,668	839,240	270,711	383,548	162,228	189,476	134,819
<b>Total revenue all governmental fund types</b>	<b>14,155,224</b>	<b>13,681,709</b>	<b>12,099,666</b>	<b>12,183,423</b>	<b>11,658,874</b>	<b>11,208,442</b>	<b>10,854,821</b>	<b>10,342,439</b>	<b>9,830,784</b>	<b>9,301,875</b>
<b>Expenditures:</b>										
General government	2,489,093	1,675,428	1,777,365	1,774,156	1,279,750	739,009	853,040	526,629	484,547	499,652
Public safety	2,108,152	2,409,668	1,765,199	1,424,846	1,659,280	1,623,362	1,310,322	1,103,606	1,241,762	1,188,814
Health	1,429,888	2,344,522	2,176,741	1,908,717	1,983,727	954,563	972,757	625,475	656,498	508,659
Public housing and welfare	3,130,373	3,320,849	2,738,016	2,953,189	2,726,129	2,315,899	2,102,410	2,485,092	1,902,902	2,086,828
Education	4,101,980	4,177,664	3,474,013	3,297,248	3,343,002	2,308,479	2,436,267	2,272,903	2,744,630	1,960,185
Economic development	516,444	706,066	868,926	428,621	637,794	170,937	337,255	314,897	186,296	333,290
Intergovernmental	409,727	—	528,829	465,699	466,169	222,721	373,016	318,664	55,739	496,844
Capital outlays	502,348	665,630	581,788	1,184,976	507,634	1,020,344	833,597	642,016	1,515,230	1,395,463
Debt service:										
Principal	446,281	391,554	526,572	330,346	2,062,059	466,467	416,369	351,722	620,866	359,851
Interest and other	822,234	733,931	737,502	1,158,749	614,347	545,001	444,595	442,614	595,053	556,835
<b>Total expenditures all governmental fund types</b>	<b>15,956,520</b>	<b>16,425,312</b>	<b>15,174,951</b>	<b>14,926,547</b>	<b>15,279,891</b>	<b>10,366,782</b>	<b>10,079,628</b>	<b>9,083,618</b>	<b>10,003,523</b>	<b>9,386,421</b>
<b>Other financing sources (uses):</b>										
Transfers in	1,423,240	1,745,992	1,034,090	1,664,278	966,935	756,229	1,026,581	992,667	1,116,455	1,255,621
Transfers out	(1,180,598)	(1,253,216)	(830,832)	(1,385,218)	(779,752)	(2,864,056)	(2,646,732)	(2,841,330)	(2,156,852)	(2,330,765)
Long-term debt issued	1,518,355	1,619,562	3,001,116	2,241,190	3,107,821	834,396	474,471	479,610	1,971,960	1,258,495
Discount on bonds issued	(323)	(6,078)	(23,061)	(36,204)	(16,075)	—	—	—	—	—
Capital leases	4,580	847	2,300	58,897	—	—	—	—	—	—
Refunding bonds issued	—	—	2,372,689	1,754,686	1,636,838	329,370	54,645	117,529	631,906	335,155
Payment to refunded bond escrow agent	—	—	(2,316,910)	(1,754,686)	(1,665,811)	(227,369)	(54,645)	(117,529)	(632,822)	(333,111)
Other	54,135	—	—	—	327,785	—	—	—	140,000	—
<b>Total other financing sources (uses) all governmental fund types</b>	<b>1,819,389</b>	<b>2,107,107</b>	<b>3,239,392</b>	<b>2,542,943</b>	<b>3,577,741</b>	<b>(1,171,430)</b>	<b>(1,145,680)</b>	<b>(1,369,053)</b>	<b>1,070,647</b>	<b>185,395</b>
<b>Net change in fund balances (deficit)</b>	<b>\$ 18,093</b>	<b>(636,496)</b>	<b>164,107</b>	<b>(200,181)</b>	<b>(43,276)</b>	<b>(329,770)</b>	<b>(370,487)</b>	<b>(110,232)</b>	<b>897,908</b>	<b>100,849</b>

The annual special tax of 1.03% of the assessed value of all real and personal property not exonerated from taxation, collected by the Municipal Revenue Collection Center on the Commonwealth's behalf, is presented as property tax from 2002 henceforth but as intergovernmental revenue in prior years.

In 2002, the Commonwealth adopted GASB No. 34. This statement requires that component units be included as expenditure by function. In prior years, such payments were reported as operating transfers-out to component units.

**COMMONWEALTH OF PUERTO RICO**

Fund Balances of Governmental Funds

Last Four Fiscal Years

Modified-Accrual Basis of Accounting

(In thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
General fund:				
Reserved	\$ 770,628	810,314	1,102,232	262,758
Unreserved (deficit)	<u>(1,154,383)</u>	<u>(1,321,585)</u>	<u>(1,468,182)</u>	<u>(342,941)</u>
Total general fund	<u>\$ (383,755)</u>	<u>(511,271)</u>	<u>(365,950)</u>	<u>(80,183)</u>
All other governmental funds:				
Reserved	\$ 73,346	45,546	72,455	33,047
Unreserved reported in:				
Debt service funds	143,732	156,564	119,830	168,928
Special revenue funds	358,452	256,949	449,455	506,252
Capital project funds	<u>219,163</u>	<u>437,923</u>	<u>744,577</u>	<u>228,215</u>
Total all other governmental funds	<u>\$ 794,693</u>	<u>896,982</u>	<u>1,386,317</u>	<u>936,442</u>

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**Commonwealth of Puerto Rico**  
**General Fund Net Revenue**  
**For the last ten fiscal years**  
**(In thousands)**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
<b>Total</b>	<b>5,600,748</b>	<b>5,902,506</b>	<b>6,550,043</b>	<b>6,943,613</b>	<b>6,962,134</b>	<b>7,454,399</b>	<b>7,841,742</b>	<b>7,985,388</b>	<b>8,305,669</b>	<b>8,541,238</b>
<b>From internal revenue</b>	<b>5,335,879</b>	<b>5,630,040</b>	<b>6,271,392</b>	<b>6,647,632</b>	<b>6,632,090</b>	<b>6,865,454</b>	<b>7,505,866</b>	<b>7,622,201</b>	<b>7,937,772</b>	<b>8,185,413</b>
<b>Tax revenue</b>	<b>5,095,218</b>	<b>5,358,805</b>	<b>5,982,504</b>	<b>6,344,398</b>	<b>6,204,639</b>	<b>6,428,083</b>	<b>6,910,345</b>	<b>7,091,198</b>	<b>7,374,589</b>	<b>7,735,669</b>
Property taxes	8,286	5,673	2,214	1,131	287	-	-	-	3,949	1,106
Income taxes, total	3,610,016	3,972,869	4,433,804	4,856,011	4,778,590	4,878,418	5,170,294	5,297,931	5,485,950	5,989,906
Individuals	1,825,337	2,026,612	2,244,376	2,352,066	2,259,090	2,449,982	2,767,678	2,720,920	2,885,903	3,087,748
Corporations	1,440,691	1,527,415	1,653,762	1,781,862	1,696,766	1,706,137	1,776,985	1,831,027	1,870,937	1,872,458
Partnerships	2,120	4,404	2,087	2,339	3,026	2,670	2,101	3,005	3,245	2,787
Withholding to nonresidents	88,603	192,463	369,384	557,276	696,835	583,256	517,141	631,100	612,005	921,260
Tollgate tax (regular)	83,640	65,285	49,249	57,203	23,664	44,213	35,576	24,411	17,611	19,570
Tollgate tax (prepayment)	126,605	105,668	65,284	53,927	25,847	15,302	9,745	7,168	5,362	7,826
Interest subject to 17%	7,582	11,406	10,666	11,674	14,782	14,310	11,278	10,108	10,489	11,536
Taxes on dividends	35,438	39,616	38,996	39,664	58,580	62,548	49,790	70,192	80,398	66,721
Inheritance and gift taxes	4,028	1,380	1,811	3,109	7,475	1,962	2,825	15,691	7,129	9,466
<b>Excise taxes, total</b>	<b>1,419,353</b>	<b>1,312,716</b>	<b>1,473,827</b>	<b>1,410,346</b>	<b>1,341,949</b>	<b>1,465,128</b>	<b>1,651,350</b>	<b>1,693,345</b>	<b>1,792,345</b>	<b>1,643,881</b>
Alcoholic beverages, total	229,043	238,118	243,464	236,374	237,512	249,705	299,582	296,302	298,235	292,180
Distilled spirits	51,855	48,034	47,519	49,425	46,963	51,734	58,389	61,306	56,641	54,056
Beer	167,321	178,465	181,348	170,065	177,448	179,737	223,309	217,568	221,902	219,379
Other beverages	9,867	11,619	14,597	16,884	13,101	18,234	17,884	17,428	19,692	18,745
General taxes, total	1,190,310	1,074,598	1,230,363	1,173,972	1,104,437	1,215,423	1,351,768	1,397,043	1,494,110	1,351,701
Cigarettes	120,287	111,094	119,105	115,157	119,135	116,055	149,487	144,733	146,527	135,267
Petroleum products	22,095	6,172	5,562	4,689	7,046	5,095	5,860	4,934	5,143	5,146
Motor vehicle	365,820	350,004	411,573	389,995	406,252	418,024	499,252	551,181	606,662	533,957
Horse races	29,138	27,401	21,405	26,351	18,893	22,033	28,872	28,865	31,463	30,786
Insurance premiums	19,430	19,364	20,368	21,564	22,845	24,290	26,771	27,217	28,324	43,055
Cement	2,234	1,702	2,417	2,531	2,707	3,426	3,279	3,432	3,228	2,919
Slot machines	-	12,230	26,330	30,869	-	36,953	90,018	76,966	85,513	23,167
Crude oil and derived products	158,739	51,636	70,056	24,786	1,901	38,619	12,925	-	-	-
5% general excise tax	446,500	468,425	520,351	525,561	508,972	486,302	505,709	535,381	557,323	551,723
Hotel rooms	12,139	13,299	15,923	17,275	-	-	9,056	-	-	-
Others	13,928	13,271	17,273	15,194	16,686	64,626	20,539	24,334	29,927	25,681
Licenses	53,535	66,167	70,848	73,801	76,338	82,575	85,876	84,231	85,216	91,310
Motor vehicles	42,354	46,268	46,781	49,133	49,834	54,896	58,426	55,638	55,669	59,525
Entertainment machines	-	7,327	9,235	10,545	11,322	12,874	13,932	14,393	15,019	16,981
Alcoholic beverages and others	11,181	12,572	14,832	14,123	15,182	14,805	13,518	14,200	14,528	14,804
<b>Non-tax revenue</b>	<b>240,661</b>	<b>271,235</b>	<b>288,888</b>	<b>303,234</b>	<b>427,451</b>	<b>437,371</b>	<b>595,521</b>	<b>531,003</b>	<b>563,183</b>	<b>449,744</b>
Traditional lottery	52,829	57,986	59,206	63,779	57,482	61,358	67,621	65,387	64,638	62,729
Electronic lottery	47,994	54,681	53,013	70,209	70,211	57,897	89,443	86,115	68,011	55,212
Transfer in from non-budgeted funds	-	-	-	-	89,093	80,000	123,600	-	-	-
Miscellaneous	139,838	158,568	176,669	169,246	210,665	238,116	314,857	379,501	430,534	331,803
<b>From non-internal revenue</b>	<b>264,869</b>	<b>272,466</b>	<b>278,651</b>	<b>295,981</b>	<b>330,044</b>	<b>344,848</b>	<b>335,876</b>	<b>363,187</b>	<b>367,897</b>	<b>355,825</b>
Custom duties	61,114	72,206	61,355	50,231	43,154	30,595	34,266	25,918	26,731	9,553
Excises on off-shore shipments	\$ 203,755	200,260	217,296	245,750	286,890	314,253	309,958	328,921	341,166	346,272
Administrative measures						244,097				

Note: The net revenue presented above includes certain revenue and operating transfers-in from other funds presented in the combined statement of revenue and expenditures- budget and actual- budget basis.

Source: Puerto Rico Treasury Department.

COMMONWEALTH OF PUERTO RICO

Legal Debt Margin Information

Last Ten Fiscal Years

(In thousands)

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Internal revenue average for two years	\$ 8,061,593	7,779,987	7,564,034	7,185,660	6,748,772	6,639,861	6,459,512	5,950,716	5,482,960	5,155,399
Legal debt limit – 15% of internal revenue average for two years	1,209,239	1,166,998	1,134,605	1,077,849	1,012,316	995,979	968,927	892,607	822,444	773,310
Maximum debt service requirement	680,742	630,685	598,547	599,611	521,035	588,359	561,918	532,324	533,241	479,017
Additional legal debt service requirement margin		536,313	536,058	478,238	491,281	40,762	407,009	360,283	289,203	294,293
Total maximum debt service requirement as a percentage of internal revenue average for two years	8.44%	8.11%	7.91%	8.34%	7.72%	8.86%	8.70%	8.95%	9.73%	9.29%

Legal Debt Margin Calculation for Fiscal Year 2006

Internal revenue for the year ended June 30, 2005	\$ 7,937,772
Internal revenue for the year ended June 30, 2006	8,185,413
Total internal revenue for the years ended June 30, 2005 and 2006	\$ 16,123,185
Internal revenue average for the two years	\$ 8,061,593
Legal debt limit – 15% of internal revenue average for the two years	\$ 1,209,239
Maximum debt service requirement	680,742
Additional legal debt service requirement margin	\$ 528,497
Total maximum debt service requirement as a percentage of internal revenue average for two years	

Sources: Governmental Development Bank for Puerto Rico General obligation debt service may not exceed 15% of the average of the internal revenues for the last two fiscal years.

**COMMONWEALTH OF PUERTO RICO**

Ratio of Annual Debt Service for General  
Bonded Debt to Total General Expenditures

Last Ten Fiscal Years

(In thousands)

	<b>Total debt service</b>	<b>General governmental expenditures</b>	<b>Ratio (%)</b>
Fiscal year:			
2006	\$ 565,137	15,849,707	3.6%
2005	491,394	16,425,312	3.0
2004	459,336	15,174,951	3.0
2003	362,136	14,926,547	2.4
2002	608,674	15,279,891	4.0
2001	538,436	10,366,782	5.2
2000	507,336	10,079,628	5.0
1999	468,970	9,083,618	5.2
1998	435,894	10,003,523	4.4
1997	430,153	9,386,421	4.6



**COMMONWEALTH OF PUERTO RICO**

Demographic and Economic Statistics

Last Ten Fiscal Years

	<u>Population *</u>	<u>Per capita income</u>	<u>Median age</u>	<u>Life expectancy</u>	<u>School enrollment</u>	<u>Labor force**</u>	<u>Unemployment rate (%)</u>	<u>Gross product (current prices)***</u>	<u>Real gross product (2000 prices)***</u>
Fiscal year:									
2006	3,928	\$ 12,997 (p)	34.4	76.8	770,831	1,420	11.7	\$ 56,688 (p)	45,111 (p)
2005	3,912	12,365	34.4	76.8	757,450	1,385	10.6	53,601	44,813
2004	3,895	11,724	33.8	76.8	764,861	1,360	11.4	50,709	43,967
2003	3,879	11,429	33.3	76.8	776,095	1,352	12.1	47,479	42,795
2002	3,859	10,921	32.9	75.2	792,284	1,309	12.1	45,071	41,901
2001	3,840	10,732	32.6	74.0	799,933	1,278	10.5	44,047	42,044
2000	3,816	10,204	32.2	74.0	748,769	1,292	11.0	41,419	41,419
1999	3,800	9,659	31.8	75.0	752,448	1,306	12.5	38,281	40,225
1998	3,781	9,108	31.4	73.0	752,171	1,318	13.7	35,111	38,658
1997	3,759	8,729	31.0	73.5	765,767	1,298	13.1	32,343	37,442

Source: Puerto Rico Planning Board, Department of Education, Department of Labor and Human Resources, and General Council of Education of the Commonwealth. The enrollment in private schools is an estimate.

\* Population as of July 1st (In thousands)

\*\* amounts expressed in thousands

\*\*\* amounts expressed in millions

(p) Preliminary figures.

COMMONWEALTH OF PUERTO RICO

Average Employment by Sector

Last Ten Fiscal Years

(In thousands)

Sector	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Agriculture	22	26	25	24	23	21	24	27	31	31
Manufacturing	136	138	136	134	137	157	158	159	161	162
Construction	87	87	88	82	84	84	84	78	69	64
Trade	271	261	253	252	236	239	237	228	236	228
Finance, insurance, and real estate	47	43	41	42	42	39	42	42	40	37
Transportation, communications, and public utilities	59	59	56	57	62	56	55	59	59	59
Services	354	349	340	328	311	298	304	306	297	285
Government (1)	278	274	268	269	257	248	247	245	245	261
Total (2)	<u>1,253</u>	<u>1,238</u>	<u>1,205</u>	<u>1,188</u>	<u>1,152</u>	<u>1,144</u>	<u>1,150</u>	<u>1,143</u>	<u>1,139</u>	<u>1,127</u>

(1) Includes the Commonwealth, its municipalities, and federal government, and excludes public corporations.  
Sources: Puerto Rico Department of Labor and Human Resources, Household Survey.

(2) Totals may not add due to rounding.

COMMONWEALTH OF PUERTO RICO

Tourism Indicators

Last Ten Fiscal Years

	2006 (p)	2005	2004	2003	2002	2001	2000	1999	1998	1997
All hotels and hostelry registration	2,152,472	2,097,606	2,008,730	1,964,963	1,821,274	1,836,377	1,674,092	1,637,620	1,570,683	1,461,567
Occupancy rates	67.9%	67.7%	68.9%	64.9%	67.8%	66.7%	70.7%	71.9%	67.3%	69.8%
Number of rooms	13,577	13,459	12,864	12,788	12,768	12,353	11,928	11,102	11,848	10,869
Visitors expenditures*	\$ 3,369	3,239	3,024	2,677	2,486	2,728	2,388	2,139	2,233	2,046

\*Amounts expressed in millions of dollars.

(p) Preliminary figures.

Sources: Puerto Rico Tourism Company and Puerto Rico Planning Board.

**COMMONWEALTH OF PUERTO RICO**

**Operating Indicators by Function**

**Last Ten Fiscal Years**

<b>Function</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>
<b>Fire protection:</b>										
Number of stations	94	94	98	93	93	92	96	92	91	91
Fire personnel and officers	2,233	2,233	1,851	1,894	1,867	1,852	1,818	2,004	2,004	1,791
Calls answered	10,435	11,514	10,716	12,340	13,256	14,271	31,681	28,575	23,299	37,698
Building inspections conducted	73,360	71,610	56,093	53,750	41,415	31,693	44,396	14,621	30,139	32,402
<b>Police protection:</b>										
Number of stations	238	234	231	228	235	239	238	236	234	448
Police personnel and officers	20,552	20,806	21,185	21,079	20,468	20,800	20,822	20,305	19,934	17,650
Calls answered	7,146	7,178	6,907	5,538	4,673	4,957	5,059	4,545	4,748	5,000
<b>Water system:</b>										
Customers	1,285,732	1,251,699	1,256,981	1,238,461	1,209,834	1,195,038	1,179,109	1,163,673	1,148,284	1,141,648
Water consumption (millions of cubic meters)	365	356	359	350	349	348	350	348	343	364
<b>Electric distribution system:</b>										
Customers	1,450,227	1,438,699	1,419,602	1,401,301	1,383,888	1,365,668	1,344,907	1,326,055	1,309,954	1,291,633
Electricity consumption (millions of kilowatt)	20,620	20,507	20,260	19,887	19,130	18,723	18,144	16,989	17,457	16,118
Electricity production (millions of kilowatt)	24,870	24,500	24,100	23,717	22,514	22,132	21,461	20,140	20,725	19,143
<b>Education:</b>										
Enrollment in public schools:										
Kindergarden to sixth grade	306,073	323,270	321,653	326,606	334,929	341,467	341,470	350,714	354,098	354,226
Seventh to ninth grade	135,166	137,717	142,305	146,896	146,837	145,858	145,908	144,157	143,382	145,591
Tenth to twelfth grade	122,251	118,491	116,829	118,519	117,072	119,162	118,498	114,684	111,798	117,340
Enrollment in private schools:										
Kindergarden to sixth grade	128,645	110,283	117,622	117,622	119,648	119,648	91,321	91,321	91,321	91,284
Seventh to ninth grade	41,888	36,448	37,226	37,226	41,256	41,256	28,908	28,908	28,908	31,244
Tenth to twelfth grade	36,808	31,241	29,226	29,226	32,542	32,542	22,664	22,664	22,664	26,082
<b>Enrollment in universities and colleges:</b>										
Public	68,813	71,044	74,056	74,801	73,974	73,846	73,846	72,010	70,765	68,838
Private	140,734	136,650	132,735	125,041	117,578	100,704	100,704	103,623	101,020	106,552

Source: Various agencies and component units of the Commonwealth. The enrollment in private schools is an estimate.